

PRESENT-DAY BANKING IN INDIA



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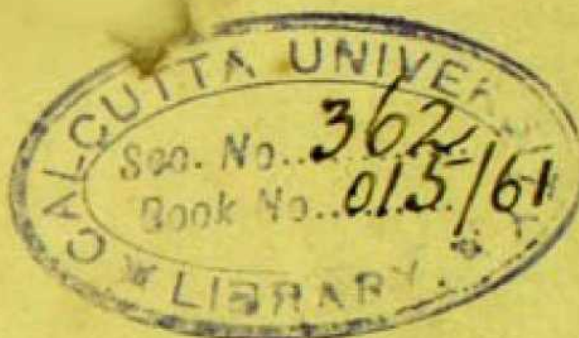
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PRESENT-DAY BANKING IN INDIA



BY

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To
The Hon'ble
SIR ASUTOSH MOOKERJEE,
Kt., C.S.I.

This book is respectfully dedicated
by the Author as a token of his affection,
admiration, respect and gratitude.

PREFACE TO THE THIRD EDITION

Bearing in mind the changes that have taken place during the eventful years of 1925-1927 I have rewritten the second edition pointing out the effects of such changes on the general public, the Imperial Bank of India, the immigrant Banks, the indigenous joint-stock banks and the indigenous bankers of our country. The descriptive material in the different chapters has been brought up to date. The long chapter on Banking Reform has been split up and rearranged into different chapters. The most important additions are the chapters on the Central Bank of Issue, Organised Banking in the Days of John Company, the Capital Market and the Investment Market, the Loan Companies of Bengal and Recent Monetary Reform.

It is a matter of sincere gratification to note that most of my views, valuable hints and fruitful suggestions offered in the previous edition have been accepted by the recent Royal Commissions on Currency and Agriculture. The 1926 Conference of Registrars of Co-operative Societies have practically endorsed the suggestion for a separate credit organisation for granting long-term credit facilities to agriculture. The idea of starting a separate State Bank for financing agriculture and industries which immature Indian authors generally mechanically repeat has been happily knocked on the head. The recommendations of the Hilton-Young Commission, the External Capital Committee and the Royal Commission on Agriculture which aim at setting right the currency and the financial system of the country, and the reorganisation of the rural credit system of the country have like myself clearly pointed out the necessity of breaking the gauge in the existing banking organisation. Most of my suggestions are repeated afresh by these authoritative bodies. One of my intelligent reviewers, who does not however give me any constructive suggestions, writes that "in his long chapter on banking reform he anticipates a good few of the suggestions made by Sir Basil P. Blackett in his very informing and suggestive address to the Delhi

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University, *e. g.*, "the standardisation of the forms of Negotiable Instruments, the use of the vernacular in the printing of the cheques, the need for special banking legislation apart from the general Company Law,¹ etc."

The establishment of the One Reserve System, the abolition of the stamp duty on bills of exchange, the creation of a Central Bank of Issue, the fusing of the indigenous banker as an integral feature of the organised banking system, the undertaking of acceptance business by the Banks and the creation of a discount market, have been pointed out by me and these are some of the very suggestions which are offered by the present-day publicists for the improvement of the banking system. With reference to the exchange, the investment and the discount markets and the reorganisation of the indigenous banker's business I have added further suggestions in the different chapters of this book. I have suggested measures to remedy the defects of the existing law in regard to the responsibility of directors. Means to improve the investment habit on the part of the people have been recommended. The necessity of compelling the exchange banks to afford prospects of a career in banking and thus creating an Indian banking personnel has been pointed out. Some of the present defects of co-operative finance, the unreliability of some of the shroffs, the amount of possible competition between the Imperial Bank and the other Joint-Stock Banks and the dangers underlying the recent merger between the Big Five and the Exchange Banks in our money market, have been outlined. Attention has been drawn to the working of the agricultural banks of other countries, and the lessons that have to be learnt from their example are pointed out. I have indicated the steps by means of which the Central Bank of Issue can gradually secure control over the internal credit situation and I have devoted special attention to free the study of banking organisation from all non-essentials, so that the reader can comprehend it clearly and barring the collection of data and statistics which a Government Committee alone can collect I have endeavoured my level best to make a scientific survey of the existing banking organisation and present a programme on clear-cut lines for immediate attention on the part of

¹ See the *Servant of India*, dated the 4th March 1926.

the bankers, the general public and the Government. Safe and sturdy banking development under the regulation and control of a Central Bank affords the only reliable means for the proper and healthy economic progress of our country.

I have suggested practical scientific remedies for enabling the people to shake off their hoarding habit. I have attempted to probe deep into this "old problem" obscured by an overgrowth of peculiar misconceptions, fads, and exaggerations of specialists and scientific inexactitudes resulting from purposeless or ineffective inquiries. There is no greater prevailing misconception than that India has hoarded, in utter disregard of economic considerations, and that the Indian still persists in the hoarding habit in the same manner and to the same degree. The Indian is not a mere slave to the primeval instinct of acquisitiveness. His hoarding is the direct result of prudence, economic needs and unforeseen contingencies. Doubtless he may be mistaken but he is not perverse. I have proved by a process of elimination that there is no considerable portion of the population which continues to keep its savings in the form of idle cash. As there is still left much of the evil to tackle I have made a list of practical suggestions which would go a long way in ensuring a truly economic use of the national savings. Some of my practical suggestions would go to the root of the matter and act as a sharp spur to economic improvement. I will only add that the usefulness of the Central Bank of Issue will depend on its ability to get into close and living touch with and alter for the better the economic life of the large masses of India's rural population. There is no discussion of this important problem before the Royal Commission on Agriculture and the Banking Committee should not fail to tackle this problem.

Another salient lesson which I propose to emphasise is the necessity to solve our problems in banking, currency and industry by measures which go hand in hand. Fragmentary reform of currency or banking is futile. Simple, intelligible and reliable measures which pay proper heed to the habits of the people are essential.

In the chapter on Organised Banking in the Days of John Company I have succeeded in pointing out the work of a few banking institutions whose names alone are known to the existing contributors

on the subject. I have literally exhumed from the graves in which they have been buried the unrecorded material of some banks of this period and they find a place for the first time in any book on Indian Banking. As students of archæology by finding a bone here, a piece of tessellated pavement there, in another place some pottery or rust-eaten apparel have caught glimpses of our civilisation, so also I have tried to collect heterogeneous facts from published Government records, old books, pamphlets and newspapers of this period and present a comprehensive list of some of the banks working during this period.

In my forthcoming monograph on Organised Banking in the Days of John Company further details and a more comprehensive account of these banks, whose history has been unearthed for the first time, would be presented. The present banking system of India is a very different thing from what it was. It has been my aim to show in this monograph the economic forces at work in this period. Bankers, like other human beings, are creatures of their environment. As heirs of all the past ages it behoves us to know the working of these institutions that did their duty in the dim past for the past always lives on and works on in the present. Lessons will be drawn from the lives of the dead (bankers) and a study of the right inference drawn would go a long way in eradicating unsound banking management in this country.

This book is only a companion volume of my book "Elementary Banking for Indian Beginners" where the theory underlying the successful working of a commercial bank and every other specialising banking concern is taught in a "clear and concise manner" as the American Economic Review puts it. The bibliography at the end of this book would be of use to all who are interested in pursuing their studies further in this direction. I hope readers would judge the work by the accuracy of its recommendations and not by the atmosphere in which they are stated.

It has been my endeavour throughout the book to avoid outlining cut-and-dried schemes either in the matter of framing banking legislation or in the matter of formulating proposals for starting industrial, agricultural or any other kind of specialised banking institutions. Throughout the book the object has been to indicate the theoretical necessity and outline a basis for the new changes and give sufficient



PREFACE TO THE THIRD EDITION

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indication of the practice of foreign countries in these lines in support of the line of reasoning adopted by me. I am much obliged to the Syndicate of the Calcutta University for permitting the Punjab Co-operative Union, Lahore, to undertake a translation of the second edition of this book into Urdu.

I desire to express my thanks to the editors of the different Journals, *e.g.*, *Bengal Past and Present*, the *Calcutta Review*, the *Welfare*, the *Mysore Economic Journal*, the *Indian Finance*, the *Cosmopolitan*, the *Servant of India*, the *Indian Journal of Economics*, the *Modern Review* and the *Capital* for permitting me to incorporate some of my recent contributions on banking in this new edition. My thanks are due to Hon'ble Mr. Ramaprasad Mookerjee and Raja Resheecase Law through whose courtesy I could gain access to the Library of the Calcutta Branch of the Imperial Bank of India. I desire to place on record my appreciation of the assistance given me by Mr. J. A. Chapman of the Imperial Library, Calcutta, without whose help I would not have gained access to important books dealing with the chapter on Organised Banking. My thanks are also due to the Consulate Generals of Japan and Germany for enabling me to secure useful information about the German banks that once did and the Japanese Banks that are still doing business in India. Only a portion of much of the material that I have gathered in this way has been made use of in this book. I have added materially much information to the account of the old Presidency Banks which has not been given either by Cooke or Brunyate. I have succeeded in pointing out the individual who was responsible for adding unconsciously the words "payable in India" after the phrase "bills of exchange" thus precluding the Bank of Bengal from transacting foreign exchange business.

B. RAMACHANDRA RAU

SENATE HOUSE CALCUTTA :

February 1929.

POST-SCRIPT

Since I handed over the manuscript to the press several important events have occurred in the banking field. The appointment of the different Banking Committees to enquire into banking conditions was announced and they have begun their work in right earnest. The liquidation of the Bengal National Bank, the sudden ending of the speculative frenzy on the Wall Street, the passing of the New Companies Act of 1929 in the United Kingdom, the Hatry Crash, the passing of the Punjab Money-Lender's Bill, the starting of an International Bank of Settlements and the harmonious manner in which the German reparations payments have been settled, the events which compel the entry of India as a borrower in the London Money Market, are some of the recent financial events. I decided not to attempt to discuss these measures for two reasons. The book has already reached an unmanageable size. Being engaged in the task of investigating the history of some of the older banks I could not find the necessary time to comment on these measures. It is my intention to complete this study later when I recover from my present ill-health and the shock of domestic bereavement. I thank the Superintendent of the Press and the Senior Proof Reader for reading the proofs with care and diligence. I acknowledge with pleasure the unusual ways in which Dr. Pramathanath Banerjea, my chief, has stimulated me in the publication of this book.

B. R.



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PRESENT-DAY BANKING IN INDIA

CHAPTER I

THE INDIAN MONEY MARKET

The importance of credit—The constituents of the money market—The functions of the money market—Some of the salient features of the Indian money market—The Treasury balances and the money market—India is a vast sub-continent—General characteristics of the busy season—General characteristics of the slack season—Some notable features of banking practice in India—Is there no autonomous money market in India?—Stages in the evolutionary development of the money market—How to stabilise the money market?—The intelligent guidance of the Central Bank.

The Importance of Credit.

Apparently Lord Byron was wrong when he wrote that "Cash rules the camp, the court and the grove." He ought, it seems, to have added that "not cash alone but credit also rules the camp, the court and the grove." We are not in need of any commentary upon statements of this kind. Even the man in the street can easily realise that credit is the life-blood of commerce. To promote agricultural and industrial advance a productive use of credit is essential. An elastic credit system can be created only by a well-developed money market. A fully co-ordinated system of credit possessing different types of complementary institutions can never exist without its indispensable concomitant, a well-developed and reasonably planned money market. The development of the one leads to the perfection of the other and *vice versa*. The money market is the groundwork of the country's national finance whose main flexibility depends on a fine division of labour and

capacity for adjustment to changing conditions of society. The liquidity of the money market is such that cash can be secured within a few hours' notice. As one recent writer says, "what a bank balance is to the individual the money market is to the country's credit system. Both represent ready cash available for immediate needs." It is on account of this feature that the bill market, the exchange market and the investment market have very intimate and close connection with the money market and occupy a position of real importance in the money markets¹ of the country.

The Constituents of the Money Market.

The money market is the centre where the borrowers of money and the lenders of money meet together. The Indian money market is generally divided into (1) the European money market consisting of (a) the Imperial Bank of India, (b) the European Exchange Banks; (2) the Indian or native money market consisting of (a) the Indian Joint-Stock Banks, (b) the shroffs, the indigenous bankers and the money-lenders who do a good deal of business in the giving of monetary credits. It is these that furnish the needed credit in our money market. The main duty of the co-operative credit societies is to finance the agriculturists and the petty artisans and craftsmen of the towns. The money market is the place to which the floating capital of the community gravitates to find employment till the time when it is needed. The total amount of the banking funds, *i.e.*, the

¹ It is usual to speak of the whole country as one money market and also refer to individual money markets of different centres. Just as the London Money Market and the New York Money Market are the national markets for their countries where the surplus funds find employment, so also in this country Bombay and Calcutta are the leading national money markets of this country. One distinguishing feature is that the banking and financial operations in the Calcutta Money Market, like its trade and business, are solely under European management. Secondly, money rates in the Bombay market are always firmer than in Calcutta. Specially in the busy season there is a great divergence between the two rates. The real explanation for this difference lies in the fact that jute-financing is done when no other crop makes a demand for finance and the jute interests possess large financial resources of their own. Whereas cotton is financed in the midst of the busy season when pressure for rice-financing also is keenly-felt and cotton is financed largely by bank credit. In January to April there is an outflow of funds from Calcutta to finance Bombay cotton and Burma rice.

available supply of funds, is adjusted to the demand for funds throughout the country.

The borrowers of money are (a) the Government of India who annually float rupee loans for capital expenditure on railway and canal construction, and pursue the policy of the sale of Treasury bills in the money market for ordinary revenue account, (b) the agriculturists, (c) the entrepreneurs engaged in industries, (d) the Indian people, who need money for performing social functions, say, marriages, sraddhas and other functions that have to be performed by people enslaved by debt, superstition and brahmanic ritual. Any sketch of the present-day banking system would not be complete without the inclusion of at least the co-operative credit societies, the Post-Office Savings Banks, and the Stock Exchanges which form important elements in a highly organised money market.

The Functions of the Money Market.

The function of the money market is to furnish the needed credit amenities for the varied sections of the community. It transports capital to the hands of those who can utilise it for productive purposes so that national dividend may be augmented. The other important function which the money market in Western countries performs is the supplying of efficient currency and, by a wise and proper regulation of the same, giving relative stability to the purchasing power of the money unit. It is the latter function that has not been understood properly. Light and more light is needed by the Government and the people at large to realise that elasticity of bank currency can be produced by business and that the diminution of the same causes its absorption. Seasonal as well as local flexibility can be easily imparted to the currency system when bank notes and bills of exchange expand and contract with the movements of trade. So long as people hold obscure notions as regards this concept of elastic currency no real improvement of the banking system can take place.

✓ *Some of its Salient Features.*

A close survey of the Indian money market discloses the following characteristic features. There is not plenty of loanable money in



the market to satisfy all these demands. Secondly, the credit system has not been thoroughly studied and specialised in all its various forms and manifestations by perfectly organised institutions as in the case of the foreign countries, notably Germany and Japan. Credit is generally divided into long-term credit and short-term credit. Mortgage or long-term credit is now undertaken by wealthy individuals and usurious money-lenders much to the chagrin and disadvantage of the borrowers who are exploited according to the urgency of their needs. Personal or short-term credit is granted on the strength of the general standing of the borrower or of the surety and it is generally available for short periods only. In the bigger cities this business is mainly in the hands of joint-stock banks and in the larger villages co-operative credit societies are trying to meet the needs of the cultivators, but to a certain extent the predominance of the usurious money-lender is the third factor of our capital market.

Another feature of our money market is that very few systematic attempts are pursued to develop the money power of the country by the existing banking institutions. Serious attempts have not been made in the past to induce the people to forsake their hoarding habit and turn their locked-up funds into fertile channels of industry and enrich their productive fields. The value of the small account has not been realised by the Indian banks.¹

The lack of a centralised banking institution acting as a "guide, friend and philosopher" to all the smaller institutions and the consequent lack of concentration of reserves are some of the prominent features of the Indian money market.

The existing credit system is totally lacking in elasticity and any extra demand for seasonal currency is not met by the expansion of banking credit. The Indian banks have no power of issuing notes. Their capacity to create credit in other forms is limited by their cash holdings which they maintain against their demand obligations. A

¹ In England any individual can open a banking account with five pounds only. The Indian banks stipulate for a minimum balance of Rs. 200 for opening a banking account. They do not pay heed to the relative poverty of the Indian people. Like the American Banks they should be interested in the small savings account and advertise for it exclusively.



bank's power to create credit depends solely on its cash reserve. With the small cash balances at the disposal of our banks they cannot aspire to have any expansion to satisfy the increasing want of credit in this country.

The cheque system of issuing credit has not developed to a great extent to amend the inelasticity of the currency media in our country. So there is no easing of the money market to any desirable extent during the busy season.

Another peculiarity of the Indian monetary situation is the lack of close contact or sufficient nexus between the European sections of the organised money market and the native or bazar section of the same. As the European Banks do not compete with the shroffs in the discounting of hundis of the small traders, the bazar rate for the hundis depends on the resources of the shroffs. While the rates for bills of large traders and shroffs follow very closely the Imperial Bank hundi rate it is the small traders that have to pay high discount rates as they do not inspire the same amount of confidence as regards their stability which the larger traders succeed in doing. Confidence and local custom generally settle the rates in the bazar market for the small traders' bills. It is generally 2 or 3 per cent. higher than the Bank rate of interest. Normally the shroffs are "outside" the influence of the organised banking system of the country. An idea of the native or bazar rate prevailing in Calcutta and Bombay can be gained by studying the annual reports of the Controller of Currency¹ and it need not be stated that the moffusil bazar rates would be higher than the bazar rates in the better organised money markets of Calcutta and Bombay.

Again when money is tight the call money rate rises to $5\frac{1}{2}$ per cent., or roughly 1 per cent. lower than the Imperial Bank rate. Call money is usually lent without taking any security from the borrowers but there were never many failures to repay the loans promptly. Another anomaly in this connection is that the Inter-bank call money rate might be low owing to easy money conditions in the market while the Imperial Bank rate might be ruling very high owing to its reduced

¹ See Appendix I where the different money rates are arranged in a table and lessons are drawn from a study of conditions ranging over a course of three years.

cash balances.¹ This is one instance which shows that the Imperial Bank rate has generally no control over the other rates in the market and there is a divorce between the bank rate and the money rates in banking circles. Although the Government of India can at such times increase their balance by issuing currency against *ad hoc* securities it might not be done as a result of its fighting shy of inflation.² But if it is only the reverse process of previous deflation no such delay should be made.

One unwholesome condition of the money market is the lack of tranquillity in the money rates. So late as in 1924-25 busy season the bank rate rose to 9 per cent. and it fell to four per cent. after a few months. In a few months it again advanced to seven per cent. There are not sufficiently strong compensating influences against these large movements of money rates. Though the visible trade balance might be actually in favour of India on account of lively export activity, yet as a result of the rigid inelastic credit system high bank rates prevail. So arises the famous and puzzling economic paradox of high exchange and a high discount rate going together.³

The Government of India acts as the currency authority which is entirely responsible for the expansion and contraction of currency and "its management" as some critics put it "is neither knave-proof nor fool-proof." The Government's currency reserve does not substantially aid the operating power of the Banks. The Currency Reserves are not available for the reconstruction of credit either in the short-term market or in the long-term market to the fullest possible extent. Its policy as regards the floating of loans or stabilisation of exchange is generally responsible for changes in the bank rate which ought to fluctuate solely according to the state of funds and their demand in the money market. The currency authority being different

¹ In the third week of November, 1928, the bank rate was raised to six per cent., while the money rate actually cheapened from 2 per cent. to 1½ per cent. for short-term credits.

² It is indeed a bad practice to issue notes against "ad hoc" securities or "createds" and if it is true that the Secretary of State has prohibited this device it should be regarded as a welcome sign on the part of the currency authority to pursue sound methods of finance.

³ Dr. Marshall was asked to explain this paradox of Indian banking before the Fowler Committee on Indian Currency—1899—see his Answer 11808.



THE INDIAN MONEY MARKET

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✓ from the credit authority there is no proper co-ordination between the two and the lack of power on the part of the credit authority to control the money market makes it unorganised. Of late 1928 the currency authority is undoubtedly doing something to provide emergency currency¹ and the policy of purchasing sterling in India in order to remit to the Home Treasury undoubtedly constitutes something towards easing the money market. The reintroduction of the Treasury bills by the Government is also for the same object. So long as the Government would continue as the currency authority some means to inflate or deflate currency to suit the business requirements are essential and free mobility of money can never be secured in the Indian money market which is subject to seasonal variations without such suitable devices.

Even if the Government were not to be the controlling currency authority it would still hold the whip hand in the money market though it might or might not use its controlling power. The impingement of the Government financial operations on the money market has not been carefully stated in any treatise on Indian banking as yet. It is well-known that temporary strain and ease can be created at times when taxes are collected and large disbursements on Government item are made. The effects of the flow of revenue and ebb of payments are well-known to bankers. At such times it is the bounden duty of the Government to minimise the adverse effects and disorganising influence of its actions on the money market, commerce and industry. ✓ This leads us to the discussion of the Treasury Balances and their effect on the Indian money market. Although it is true that a Central Bank affords absolute guarantee for the unvarying management of its treasuries under its controlling power and a certainty of greater economy in the use and distribution of its balances throughout the country, still such a powerful banking agency does not exist as yet in this country and the Government is consequently forced to maintain a few treasuries of its own to carry out its financial operations throughout the country.

¹ This was the policy in the winter of 1927-28 and the Government supplied emergency currency against sterling securities, against *ad hoc* securities, and inland trade bills.

The Treasury Balances and the Indian Money Market.

District Treasuries and Sub-treasuries.

Unlike the British Government which maintains no outlying State Treasuries the Government of India has its funds in district treasuries and sub-treasuries distributed up and down the countryside. Besides these 1,359 outlying state treasuries, the Imperial Bank of India acts as the treasurer of the Government wherever it has a local head office or branch office. It does a considerable amount of work on behalf of the Government in the management of public funds. The following table shows the cash balances of the Government distributed at the treasuries and the Imperial Bank:¹

(In lakhs of Rupees.)

Balances at Government Treasuries.				Balances at the Imperial Bank.		
1925-26	1926-27	1927-28	Last day of the month	1925-26	1926-27	1927-28
303	253	244	April	2709	1306	1454
263	245	229	May	2843	1483	1186
262	252	237	June	2226	3230	881
248	238	214	July	2454	3629	1558
226	229	218	August	1962	3545	1574
235	232	207	September	996	2023	1256
256	233	206	October	740	1403	876
263	220	221	November	674	916	966
242	243	216	December	526	633	704
267	242	235	January	990	1344	788
268	264	225	February	1386	2016	732
369	326	313	March	2186	2463	603

Two Sections.

Unlike the Governments of most other countries of the world the Government of India has to distribute its public receipts into two sections, viz., the Treasury balances in India and the Home Treasury, and arrange for its disbursements at both centres. Its financial commitments require the provision of funds on a large scale in an

¹ See the Report of the Controller of Currency, 1927-28, p. 10.

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external centre. A glance at the following table shows the state of the treasury balances in England as well as India :

(In lakhs of Rupees.)

	In India.	In England.	Total.
1st April, 1922	2566	899	3465
31st March, 1923	2596	982	3578
" " 1924	3114	1040	4154
" " 1925	3174	1352	4526
" " 1926	2516	1506	4022
" " 1927	2788	326	3114
" " 1928	916	761	1677

The Normal Course of the Treasury Balances in India.

The financial year which commences on 1st April opens with an " ample balance " which becomes gradually depleted by the end of July. It becomes swollen as a result of the annual rupee loans floated by the Government of India. As disbursements are made the outflow becomes again greater than the inflow with the result that the treasury balance is reduced to the lowest possible limit in November and December. From January the revenue collections begin and the earnings of the commercial activities of the Government also improve during the busy season and the treasury balance in India gradually expands till the end of the official year. When the tax collections are made " the public deposits " of the Imperial Bank and the treasury balances expand and the reverse operations of paying back the treasury bills and payment of interest on public debt would release the funds and there would be an augmentation of " private deposits " and purchasing power in the hands of the public. The accumulation of cash balances in the hands of the Imperial Bank at the last quarter of the financial year when it also happens to be the busy season of the year tends to enable the Imperial Bank to earn huge profits, and if the tendency of the public is to issue cheques in payment of taxes to the Government it would create a shortage of credit when the ingathering of revenue takes place on a large scale during this period and the Imperial Bank would soon control the credit situation and the money market at such times.

Reasons for Abnormal Variations.

This average run of the cash balances in India may be disturbed if abnormal variations occur during the course of the financial year. Some of the important causes for the variations or fluctuations of the cash balances in India are so well-known that any detailed mention is unnecessary. Any stoppage of the sale of treasury bills and undue retention of the proceeds of the rupee loans till they are used for the specific purpose for which they are floated, the slackness of trade demand for remittance which means lack of opportunities for remittance to the Home Treasury through the money market and the making of the bulk of the remittances in the earlier portion of the financial year than it is usual to do, are the chief reasons for the abnormal variations of the cash balances in India. The first two causes lead to larger treasury balances in India and the Secretary of State's Home Treasury may be augmented through the currency channel. The last-mentioned feature depletes the cash balances in India and causes an accumulation of the same in the Home Treasury.

Effect on the Money Market.

The maintenance, in a modified form even, of the treasury system¹ would withdraw funds from the money market and unless a systematic banking use of these funds is made it is apt to increase and aggravate the stringency in the money market arising out of other causes such as seasonal variations. Sound monetary conditions postulate the greatest possible economy of Government balances lying outside the banking system. A trustworthy banking agent should be in charge of the Treasury operations and so long as public deposits at the Treasury are kept idle they are not available for trade purposes. So a prompt release of these funds into the hands of

¹ The Government receives money in the different places in the interior and has to remit these resources to headquarter cities for expenditure purposes. The traders have to make remittances to secure produce. These requirements are dovetailed into each other. Traders secure remittance orders from the Government which makes a small charge for supplying bills or telegraphic transfers through the Currency. A large amount of remittance is made through this channel without any actual movement of coin. See Mr. Gillan's Report on Currency Operations in 1910-11 and the reports of subsequent years.

the bankers is necessary to avoid high money rates in the money market. As Mr. Hilton-Young points out "it is a part of the good government to avoid making credit scarcer and dearer by temporary accumulation of money in the hands of the state...A government has no business to take out of the pockets of the tax-payers and keep lying idle more of their money than is absolutely necessary for its immediate purposes. All possible measures should be taken to keep public deposits at all times as low as possible. Care in that is more needed every year. The business of the Government and the number of the state's activities steadily grows and with them grow the size of the revenue of the various funds with which the Government has to deal. Under the conditions, without constant vigilance to prevent it, there is some danger that an increasing burden may be cast upon the industries of the country by the accumulation of an increasingly large balance on the Government's accounts."¹

Government Measures to reduce the Strain.

The remittance operation of the Treasury should not be referred to in detail.² It must be admitted that the Government of India has been doing its level best to economise the treasury balances and keep them as low as possible. Since 1921 it has been the consistent policy to empower certain sub-treasuries to withdraw funds without previous sanction and the transfer of funds was facilitated largely by the opening of currency chests alongside the sub-treasuries and providing facilities for remittance through the currency chests.² The opening of more branches of the Imperial Bank and absorbing a greater portion of the Treasury work has also facilitated the problem to a great extent. These efforts have tended to throw a large portion of the funds which accumulate at the 1,359 outlying treasuries back into the hands of the Imperial Bank which is in constant contact with the money market and performs work for the Treasury practically without any charge.

¹ See E. Hilton-Young, "The System of National Finance," pp. 303 and 304.

² The Currency chests facilitate the remittance work of the Treasury by making it easy to have mutual transfers between the two. The mobility of the reserve is enhanced greatly by this measure.

*Low Cash Balances in India.*

The accumulated funds in the Treasury in India and the Imperial Bank constitute a part of the cash balances of the Government of India. These form the Indian portion of the cash balances. In the event of expenditure becoming greater than the accumulated revenue, the Government of India has devised three steps to tide over the particular situation, viz., (1) the Imperial Bank tries to help the Government by granting the ways and means advances out of its own credit reservoir. But two peculiar features of this method have to be noticed. Firstly the Imperial Bank would not often be in a position to grant substantial sums as its balances are not generally of a very substantial character. As it is not endowed with the privilege of note-issue it can count upon its own working capital which consists of its paid-up capital, reserves, and deposits. Secondly, the ways and means programme of the Government of India is not any exact estimate of the requirements and the methods adopted to acquire the necessary resources to meet the expenditure. As Sir B. P. Blackett, the ex-Finance Minister, points out, "our ways and means budget is intended to be, and necessarily must be, illustrative rather than exact. The ways and means figures bring together the net results of operations of very varying character all over India and Burma and in London. To a large extent these operations are either not under the control of the Government of India at all or only very indirectly under their control. In these circumstances it is neither possible nor desirable to attempt to lay down a rigid ways and means programme far in advance. The only result of so doing would necessarily be to swell our balances needlessly."¹ Thus it is apparent that the Government's policy is to avoid unduly large balances and try to meet the deficit in the best possible manner thrown open to them at any particular time. The method of securing of advances would be resorted to in case of sumptuous balances in the Imperial Bank. Such advances were made in 1924-25 in November to the extent of 5 crores which were repaid in January 1925 and the rate of interest paid was between three and three and a half per cent.

¹ See his Budget Speech, 1926-27.



The sale of treasury bills by tender with intermediates at fixed rates between the weekly tenders is another expedient borrowed from the British financial practice. As a temporary borrowing this method is resorted to and as soon as revenue realisations are made the Treasury bills are paid off on maturity. But both ways and means advances and treasury bills would reduce temporarily the purchasing power of the public if it is the latter that absorbs the treasury bills. If they are largely held by the financial houses, like the Calcutta Discount Company, brokers and banks, an equivalent amount of purchasing power is not cancelled.

Another expedient of increasing the Government cash balances in India is the practice of issuing currency notes against British Treasury Bills or sterling securities purchased by the Secretary of State for India and deposited in the Home branch of the Paper Currency Reserve. During 1923-24 there was an addition of twelve crores to the cash balances in India according to this method. Again in 1924-25 there was a similar transfer of balances from the Home section to the Indian portion by buying 6 crores worth of B. Treasury bills which were placed in the London branch of the P. C. Reserve and currency notes released into cash balances in India. By retransferring a portion of the cash balances from London to India the Indian resources were largely augmented.

So long as the independent and separate treasury system is maintained even in a modified form it is incumbent on the Government to see that its operations do not act in any way to the disturbance of the money market. It has already been related that the Government of India was doing its level best in reducing such non-bankable cash balances of its own in India. It has also been pursuing the policy of transferring its home balances to the Indian portion in case the latter needed any augmentation. Of late it has been pursuing the policy of selling T. bills with the avowed intention of levelling out inequalities in Government revenues and disbursements throughout the year and save interest charges by reducing the average Government balance. The other indirect advantages of the sale of T. bills also prompted the Government to reintroduce their sale. Improvement in the financial facilities of the market and the checking of seasonal fluctuations in the value of Government securities were the indirect objects aimed at by the reintroduction of the sale of the Indian T.

bills. Undue piling up of Government balances must always be avoided by paying out the same immediately. This is what the Central Banks of other countries do in the matter of their T. balances.

Some Peculiar Features of the Home Treasury.

The Home Treasury has certain peculiar features of its own which would have to be noticed in an analytical study of the Government Treasury operations on the money market. The first peculiar feature is that there is no rise and fall as in the case of the treasury balances in India. Secondly, it earns interest and, as the Hilton-Young Commission admits, "unduly large accumulations of funds were made in London as they could be remuneratively employed in the London money market."¹ The third peculiar feature is that there can be no transfer of heavy balances in India which gather in January to April to the home treasury as the busy season in the money market coincides with the period of gathering heavy revenue realisations. Relief to the I. M. market is essential and so no transfer of heavy balances from India to London can be contemplated or done actually just as any transfer of heavy balances in the Home Treasury can be transferred to India in October, November and December. We have already seen how this is accomplished by purchase of B. T. Bills or sterling securities and placing the same in the P. C. Reserve in London and releasing currency notes against the same to the cash balances in India.

The Necessity of the Home Treasury.

The necessity for accumulating the Home Treasury in London is primarily to arrange for the disbursements to be made in the United Kingdom on behalf of the Government of India. Annually about £35 million would be required for the needs of the administration under this heading. Remittance of this sum has to be made without disturbing the money and the exchange markets. If the T. balances in India are slender it precludes the possibility of remittance on a large scale and the Home Treasury would be lean or slender. The Secretary of State for India can fall back upon sterling borrowing to secure the needs of the administration. But if treasury balances are heavy in

¹ See Report of the Hilton-Young Commission, p. 46, para. 112.



India part of the same can be remitted to London with the result that the H. Treasury would have sumptuous balances. Again when the whole of the capital requirements are secured by floating rupee loans the H. Treasury balance would be lower than when a part of it is being secured by floating sterling loans.

Remittances to the Home Treasury.

The problem of annually remitting such large funds on behalf of the Government of India would have assumed grave consequences to the Indian money market but for the fact that there is a heavy demand for remittance from England to India. Whenever trade demand for remittance is keen the Government seizes this opportunity as the best time for sending funds home. At times Government remittance becomes the only important cover available to bankers during the days of busy export trade and when private remittance is anaemic the bankers fall back upon the Government remittance. As this is the present tendency underlying Government remittance it is impossible to forecast the dates and amount when the remittances would be made.¹ Sir James Brunyate wisely remarks that any such forecasting requires "not only the statistician's gift of estimating but that of prophecy would be required to fix the size of the Home treasury balance." It was not this difficulty alone that often led to unusually heavy cash balances in the H. treasury but the possibility of earning interest tempted them to pursue this procedure but unfortunately it only tended to the raising of the Indian bank rates to a high level which could have been avoided to a certain degree. Heavy Home balances may be a source of comfort in the days of weakening exchange and can be reckoned as a prop to weakening exchange. But its effect on the Indian money market has already been related.

¹ It is not only for the augmentation of the Home Treasury so as to enable it to meet the needs of the administration that remittances are usually made but they are required on behalf of the home branch of the Paper Currency Reserve which was formally opened in 1905. See also Act No. XX of 1923 for the composition of the metallic reserve of the Government P. Currency. Both gold as well as sterling securities can be held in London.

*Present-day Problems of Low Cash Balances of the Imperial Bank.*

The low treasury balances in India mean low cash balances of the Imperial Bank. Sumptuous cash balances of the Government mean fat balances for the I. Bank at the same time. Again if the money does not return promptly from the up-country centres and a hold-up takes place, the cash balances of the I. Bank would be very low. If such low cash balances were to be the chief feature at the beginning of the busy season (December to March), as is the case now in 1928 it means resort to the Controller of Currency for P. C. notes against hundies. The peak months of the busy season are December, January, February, March and April. If the demand for the marketing of jute, rice, wheat, cotton, tea, hides and skins and the spring crops of North India were to be keen the chief feature would be high bank rates. It may be raised early in the month of December. Internal bills may be placed in the Controller's hands to secure emergency currency. Although high bank rates prevail the market rates may be easy if the Government purchases sterling and maintains the floating supply of credit. Money conditions may continue to be tight during the busy season but there would be no acute stringency for the repayment of Treasury bills would ease the market situation to a great extent.

But if the demand for financing the movement of crops were to cause no heavy pressure on the I. Bank it spells stagnation of trade. Activity and profits from the commercial activities of the Government would fall to a low level. Railway finance would be the chief sufferer. The total revenue realisations of the Government would be smaller. As only one-third of the budgeted requirements of the Secretary of State is generally secured during the slack season by purchase of sterling in India the remainder cannot be secured easily; in which case resort to temporary sterling borrowing would be inevitable. If the present low cash balances were to continue the remittance programme cannot be completed as it would be dangerous to purchase sterling on a free scale with depleted cash balances in India. It is unnecessary to carry this analysis further but sufficient indication of the underlying complications in this subject, which is discussed so much and understood so little, has been made.

Such consequences would be repeated every year so long as there are low cash balances in the hands of the I. Bank at the beginning of the busy season. It is high time to cure this inelasticity of currency and credit during the busy season. Seasonal variations cannot be adequately provided for without an efficient Central Bank of Issue consciously managing the currency system in the wider interests of the country. This is the way in which the Dominions of the British Empire with the exception of Canada have solved their emergency currency problems arising out of seasonal variations for currency.

Concluding Remarks showing the necessity of reorganising the Banking System.

The maintenance of low non-bankable cash balances in India is a desirable end by itself. This can only be achieved by exact estimating in India and at Home and there should be close correspondence between the actuals and the estimates. Underestimates of receipts of any kind or overestimation of expenditure would have to be avoided. Otherwise undesignedly high balances would accumulate. If kept in the hands of the banker it would at least condone to a certain extent the evil effects of undesignedly high balances. A balanced budget will not certainly introduce great disturbances in any direction in the money market. Temporary displacements when the intake and outgo of Government revenues are made would not seriously affect the money market.

Again a full banking use of the treasury balances should be made. The creation of a central bank of issue would undoubtedly simplify this problem and the duty of the central bank would be to manage the whole of the treasury work of the Government of India. The problem of any unintended surplus has to be dealt with in the first instance. It is unwise to make use of this as the basis for the superstructure of credit, for any realisation of the same would be impossible in the near future and trade cannot be made to depend on this unexpected source which may be cut off at any time. The remittance function would undoubtedly be handed over to the Central Bank and the provision of the Secretary of State's requirements according to periodical forecasts supplied beforehand to the Central Bank, is to be left purely to the discretion of the Central Bank. If

remittance is made through the currency reserve when it could be made through the Treasury balance it produces inflation and a corresponding deflation would ultimately have to be made. It is only a Central Bank of issue with a vast reservoir of credit that can make the Treasury actually independent of the money market and rescue the Treasury in periods of emergency. It is a central bank of issue alone that can cope with the exacting requirements of a Government which keeps small balances and carries on enormous number of banking transactions.¹

Another peculiarity of the Indian foreign exchange market is that it is greatly susceptible to influences arising out of capital movements, i.e., the inflow of foreign capital into the country. The supply of investible funds within the country would reduce the interaction of the international investment market on the foreign exchange market of our country. There is a great demand for the investible savings in the country and the supply cannot be easily adjusted to suit the demand. In as much as the supply of savings cannot be immediately increased even though an attractive yield is offered the demand factor has to be regulated, but in the absence of issuing houses specialising in underwriting business the regulating of the demand cannot be done effectively. It is for this reason the writer has suggested the formation of a National Board of Investment to regulate demand as well as supply of investible savings on the part of the community. Excessive speculation is a danger in the investment market which requires prompt control. Speculation in stocks and shares is a great danger to credit stability and it should be one of the duties of the Central Bank to check speculation in the investment market.

But the main point is that with the present undeveloped money markets that are existing now we cannot hope to regulate credit in such a way as to correct the tendencies in the foreign exchange and the investment markets. As a gold standard is to be ushered in under the management of a Central Bank of Issue the real causes for the adverse movements of foreign exchange or the underlying motives for

¹ The Government not only refuses to pay a charge but expects conducting increasing financial operations with smaller balances than before when the volume of Treasury operations was small in comparison. The same is the case with most of the States. So the problem of relationship between the State and the money market is always considered a "troublesome one"—"quite as troublesome as the relation between the State and religion." See Burgess, *The Reserve Bank and the Money Market*, p. 92.

speculation on the stock market should be studied. Lest these culminate in a draining away of gold from the country the Central Bank must be in a position to make such movements as not only tend to prevent the loss of gold but counteract effectively the underlying causes initiating the adverse movements in the foreign exchange and the investment markets.

India, a Vast Sub-continent.

Before discussing the general characteristics of the busy and the slack seasons it must be realised that India is a vast sub-continent and it is quite natural that the seasonal variations should occur at different times in the different parts of the country. The following table originally adopted by Mr. M. F. Gauntlet, Controller of Currency, in his report for the year 1912-13 shows the busy and slack seasons in each currency circle.¹

Months.	Eastern India.		Western India.		N. India.		South India.
	Rangoon.	Calcutta.	Bombay.	Karachee.	Cawnpore.	Lahore.	Madras.
Busy...	3 months	3 months	7 months		8 months	10 months	6 months
Slack...	9 months	9 months	5 months		4 months	2 months	6 months
January	Busy	Slack	Busy		Busy	Busy	Busy
February	"	"	"		"	"	"
March	"	"	"		"	"	"
April	"	"	"		"	"	"
May	Slack	"	"		"	"	"
June	"	"	Slack		Slack	Slack	Slack
July	"	"	"		"	"	"
August	Busy	Busy	"		"	Busy	"
September	"	"	"		"	"	"
October	"	"	"		Busy	"	"
November	"	Slack	Busy		"	"	"
December	"	"	"		"	"	Busy

¹ Compare this table with Dr. Ambedkar's table given in his "Problem of the Rupee," p. 60. Both the tables agree so far as Rangoon and Madras circles are concerned. Dr. Ambedkar estimates 4 months, August to November, as the busy season in Calcutta. Coming to Western India he is of opinion that the busy season is from November to March ranging over a period of six months. So far as Cawnpore is concerned he estimates the busy season to extend over 6 months only, September to November and February to April. Finally the busy season in Lahore extends to 9 months from January to June and October to December.

General Characteristics of the Busy Season.

The main characteristic of the busy season is the tightness of the money market, for the outflow of money is greater than the inflow. There is a brisk demand for money and diversion of funds from the money market for the financing of the movement of export staples such as jute, cotton, seeds, wheat, rice and the spring crops of Lahore and Cawnpore. Roughly sixty per cent. of these crops are meant for export and the jute season commences early in August and money returns back to the port centres in December. The cotton exports have to be financed from October to February and the call for financing the rice crop comes during December to March and last comes the call for financing wheat, the oil-seeds and the spring crops of North India. A late jute crop and an early cotton crop or a heavy demand for these Indian products or too frequent transactions in them or a high price of these products would lead to a heavy demand for currency¹ either in the shape of cash or rupee notes for moving the crops from the up-country to the port centres. Hence there are low cash reserves, and stringent conditions prevail in the money market. The Imperial Bank of India in order to protect its own cash reserve raises the bank rate to a high level. It is not this harvest demand alone that constitutes the main demand for currency. There is the marriage season at which period also there is heavy demand for currency.² The mid-summer indolence usually gives place to abound-

¹ See M. M. Gubbay's evidence before the Babington-Smith Committee, Vol. II, p. 86. See also the annual reports of the Controller of Currency which give the readers an idea of the currency needed for financing the chief export staples.

² Stringency in the Indian money market may sometimes be due to want of confidence in exchange, precariousness of credit and consequent withdrawal of native capital from circulation in the bazar. As these are abnormal features occurring now and then they cannot be considered as the general features of the busy season of this country. Stringency may be due either to sudden and heavy demands arising in abnormal times as war, plague or famine when the normal capital supplies would be found insufficient. Again it may be due to sudden contraction of normal capital supplies while demand happens to remain the same. It is a peculiar characteristic of India that both demand and supply vary very greatly and fluctuations in bank rates would be greater in this country than anywhere else. Indian banks cannot hope to control all these different conditions and Indian bank rates cannot hope to remain so steady as is the case of bank rates in Western countries where reasons for the credit strain or disturbance can be foreseen and prevented by timely action.

ing vitality of fulsome activity. Bankers do not sit yawning behind their desks as they do in the monsoon months. The financial circles become active and there is life, vigour and fulsome activity in the busy season.

General Features of the Slack Season.

In the slack season there are plethoric credits, large cash reserves, plethoric floating balances and low money rates. Short-term money tends to become an "unusable drug in the market" as the Exchange Banks put it. Although this is an exaggeration there is always a superabundance of short credits. Investment in bullion and Government securities preponderates during this season and the purchase of imports is also undertaken. The Exchange Banks not finding it possible to lend even at $\frac{3}{4}$ per cent. generally undertake exchange operations, i.e., buy gold exchange ready and sell forward gold exchange so as to bring it back in time for the ensuing busy season. The three summer months during the year constitute the period of the slack season and as they are the monsoon months weather conditions restrict the activity of the people in all directions and there is enforced leisure. The demand for currency falls to a minimum during these three months. As Sir Basil Blackett¹ points out "the monsoon increases the wideness of the margin between the amount of currency and credit required when activity is at its maximum and the amount required when the activity is at its minimum during the year. Hence it is absolutely inevitable that money should be cheap during the summer months in India which constitute the slack season. During

Again another important feature is the abnormal need for cash or currency in this country. In the Western countries cheques and credit instruments are used largely for transactions in foreign trade, wholesale trade, security transactions, and freight movements. It is only for wage payments and family expenditure that hand-to-hand currency is demanded. The lack of detailed figures of a Central Bank of Issue would not enable the student of Indian banking to follow the weekly currency movement and nothing beyond facile generalisations as regards the size of the currency operations are offered even in the case of the annual report of the Controller of Currency.

¹ Quoted from his speech delivered at the opening of the Calcutta branch of the Central Bank of India, July 24, 1924.

that period money must be kept liquid in order that ¹ it may be available for use during the winter and spring."

These are the peaks and valleys of credit occasioned by the character of business of this country² and to these fortunes and fluctuations of the money market must be added those produced chiefly by the financial operations of the Treasury.³ The great fluctuations in the volume of government deposits and the heavy remittances to London, the inflow of funds on account of Government payments for redemption of their Treasury bills or the repayment of the ways and means advances to the Imperial Bank, have their effect on the internal credit situation in this country. The rigidity of the credit system leads to heavy and penalising rates that are imposed on businessmen and the agriculturist suffers because he has to sell at a time when a tight money market depresses prices. The agriculturists and the buyer of imported commodities have to buy their supplies when easy money conditions tend to raise prices. The bankers feel the burden of great financial anxiety when they begin to tie up their resources in the slack season in purchase of Government bonds and are always haunted by the nightmare of possible depreciation of their capital.

¹ Of late the machinery for contracting currency in May and June is systematically put into operation. The fall in exports and the return of rupees from circulation point out the redundant nature of currency. The P. C. Reserve is utilised for these operations. Transfer to the Home Treasury of the Secretary of State of the sterling securities, withdrawing of the rupee securities from the P. C. Reserve and the repaying of loans by the Imperial Bank to the Controller of Currency, would lead to contraction of paper-currency and during 1927-1928 the P. C. Reserve was thus operated upon to bring about the desired contraction from 184 crores to 171 crores at the end of May.

² Of late, the most noticeable thing is the absence of seasonal bulge of the exports. This is due to the purchasing tactics of the overseas buyers and the staying capacity on the part of the producers to carry over the produce for a longer period in anticipation of better prices. These factors are tending to mitigate the downward torrent of exports from up-country into port centres during the busy season alone. They are being exported more in slowly moving dribblets all throughout the year. This partly explains why the bank rate tends to be high even in the so-called slack season.

³ The present Government policy is to cause the minimum inconvenience to the Indian money market. Although Treasury bills are to be floated in the money market, an attempt is to be made at the same time to release the money through purchase of sterling if tightness of the money position were to ensue as a result of the sale of the Treasury bills. The economising of the Government Treasury balances is also a noteworthy feature of Government's recent financial policy.

Some Noticeable Features of Banking Practice.

Before indicating any methods for improving the money market the general differences between banking practice in India and that of the other countries must be pointed out. An understanding of these features is absolutely essential for true wisdom consists in successfully adapting these features so that an improved banking system can be created in this country. We resemble the United States of America in having widely differing regions whose special necessities have to be recognised in the formation of a Central Banking institution for the country. As in the United States of America so also here the regional branches of our Central Bank can be made to help each other in case of need. When additional money is needed in the jute area, the Bengal branch can send bills to the Madras branch for rediscounting or when the cotton crop has to be moved in the South bills can be sent to the North Indian branch for rediscounting. Cash can thus be liberated for helping the sister branches. A decentralised Central Bank plan on the model of the Federal Reserve system of America would enable this to be done more efficiently than a single Central Bank with no branches in the interior of this vast sub-continent.

In the European countries they have a Central Bank with branches in the different centres. In India we have very few big banks covering the whole country with a net-work of branches. The U.S.A. resembles this country in this matter but it is more fortunate in having a very large number of small independent local banks not scattered in squads but marshalled in armies under the leadership of the F. R. Board whose democratic organisation enables its operations to be dedicated solely for public service. ✓

Indian people do not make a wide use of cheques¹ and bills of exchange in the matter of domestic movements of goods as people of America or England generally do and in this respect we resemble Germany and France though of course their use of credit instruments is much greater than ours.² India is the only big commercial country

¹ The flow and movement of cash in India is also slower than in the case of other countries. Hence commerce and trade need more cash basis in this country than anywhere else.

² Till 1920 there was no Clearing House in France. The Chambre de Compensation was organised in Paris in 1920. Deposit banking is in its infancy and payments are

where amateurs are allowed to conduct banking business with impunity.¹ It is not traders and industrial concerns alone that carry on banking but the European firms, shop-keepers and private individuals carry on deposit-attracting business offering to pay very high rates of interest. Commerce, trading and industrial management are not compatible with successful banking. The Government have not cared to check this vicious practice by refusing to permit outsiders to deal with legitimate commercial banking business. Viewed from this standpoint banking can be defined in this country as the giving of monetary credits.

The Indian Joint Stock Banks generally undertake commercial banking business of a very conservative character. Investment banking is generally also taken up along with commercial banking by the European Continental Banks. In England and America there are special agencies for underwriting. Foreign Exchange business is a more important part of the business of the European banks than is the case with our indigenous joint-stock banks. Herein our conditions approximate more to those of the National Banks of the United States of America which, prior to the recent war, conducted purely domestic banking business only. We have copied the Scotch system of cash credit to a certain extent and the practice of overdrawing is generally allowed in the European countries. In America the tendency is to base each loan on a definite instrument. The Indian banks generally require their loans to be based on the general credit of the borrowers and the cash advance account predominates. Even the indigenous bankers finance trade largely by the book-credit system. Here again we do not seem to be following the tendency of the American Banks which insist on the

made by bills of exchange which are drawn for very small amounts and the bills are generally made payable not at the banker's but at the acceptor's own house. In 1914 deposits in twelve leading French Banks including the Bank of France amounted to approximately 5,000 million francs while the circulation of notes, gold and silver amounted to approximately 12,500 million. In England the notes and gold amounted to roughly £160 million and bank deposits to roughly £1,100 million. See D. T. Jack : "Restoration of European Currencies," p. 113. Even taking Germany into consideration the cheque system of payment was not very popular before the recent war and the Government had to exercise much pressure in this direction.

¹ See the article entitled "India's Amateur Banker"—Banker's Magazine London, August, 1925. He points out that 7½ per cent. is allowed on twelve months' fixed deposits.

creation of a large number of negotiable instruments that can be re-discounted at the Central Bank. Unless this practice is changed in our country rediscounting at the hands of the Central Bank would be an impossible feature.

Is there no Autonomous Money Market in India ?

Some critics contend that a thoroughly organised money market does not exist anywhere in India. There is no autonomy of the Indian money market. The upholders of this view point out that the Indian money market's dependence for funds is undoubtedly a proof of its subordination.¹ Isolation, absence of specialisation and differentiation of function still mark our financial organism but like the human organism itself the financial organism reaches its perfection while passing through evolutionary stages and the Indian money market has necessarily to pass through these periods of transformation before it can finally evolve as a perfected and thoroughly organised institution.

Stages in the Evolutionary Development of the Money Market.

The first and incipient stage in the evolution of the money market is the collection of the credit material. It has to be aggregated into huge masses by the great banks, the savings banks and the co-operative credit societies.² The Insurance societies have to play the part of subordinate adjuncts and trustworthy lieutenants in the process of

✓ ¹ It must however be remembered that London is the world's financial centre and "natural leader of the world in regulating credit" and is about to re-establish her old supremacy in this direction. The predominance of the London money market as the world's loan centre is chiefly due to the underwriting business undertaken by the British Investment Companies. They have also sometimes undertaken the underwriting business of industrial companies. By rebuilding her great economic strength Great Britain is adding to her net foreign holdings. The resumption of a free gold market, the continued division of labour in the highly organised money market, the regaining of her old customary channels of credit, and the pursuing of free banking as in the pre-war days, have enabled London to regain her lost monetary leadership and the "golden sceptre of finance." Hence London's credit policy would affect all money markets whose operations are closely intertwined with hers.

² More Life Insurance Companies have arisen in this country lately. Many more have to be created so as to stop the great outflow of profits which amount roughly to 10 crores of rupees per annum which foreign banks and insurance companies have been realising

accumulating money. Money should be tempted out of the small dormant hoards and thrust into useful activities. The supply of capital should be adjusted to the demand and it should be made mobile and fruitful. This is the duty of our banks and they should try to equalise supply to demand. They should avoid a plethora of money at one time or a modicum at another. They should enable the businessman to make plans years ahead with every assurance that they can continue their financial operations without being penalised by high money rates.

The next stage in the evolution of the financial organism is reached when "there is a conscious directing of functions and proper co-ordination of them. It becomes conscious of itself, aware of its own existence; tries to protect itself and to guide and control its own future. It is in this intermediary stage, an era of experimentation, that mistakes, miscalculations, reverses and misjudgments may be committed and the financial organism may be put to a trial now and then, but on the whole it endeavours to correct itself and advance on the right path and produce the machinery needed for serving public need." Then only can the financial organism evolve as "a perfected and thoroughly organised whole with proper correlation, interconnection, and due juxtaposition of the several elements to each other." ¹

According to this theory of evolution the Indian money market is slowly passing through the first stage. There is the accumulation of credit material going on. More banks should arise to mobilise our money power. The various subordinate adjuncts have to perform their mission faithfully and efficiently. The advent of specialisation and the differentiation of functions among the component members of the money market are noticeable to a certain extent but as yet no signs of calculated co-ordination are visible.

in this country. It would indeed aid the industrial and financial system of our country to a great extent. It must be pointed out in this connection that some of the Exchange Banks discriminate between the European L. I. Cos. and the Indian L. I. Cos. and refuse to accept the policies of the latter as good security. Unless more Life Insurance Companies arise and pursue a policy of sound investment in public utility industries, the industrial progress of the country would be handicapped. Both the American and Canadian L. I. Cos. invest largely in Railway Companies and immovable property as land mortgages.

¹ Dr E. Powell, "The Evolution of the Money Market."

*How to stabilise the Money Market.*

This catalogue of miscellaneous imperfections and defects of the money market might carry conviction that the banking system and the money market are honeycombed with imperfections and need improvement in detail. Systematic attempts should be made to reconstruct the money, foreign exchange and investment markets in the way outlined in the succeeding chapters. A well organised system of finance has to be built up and the oppressive influence and incubus of the money-lender must be eliminated. The credit system should be thoroughly organised. Credit has to be made cheap yet not facile. The paralysis of the existing credit system due to the insufficiency of the existing banking institutions has to be rectified. All sides of credit, *viz.*, long-term credit and short-term credit both for agriculture and industries, should be specialised by the existing banks. The habit of thrift must be encouraged. The folly of improvidence should be checkmated. The various sections of the people have to be taught the usefulness of credit and its right use at the right time. Since the economic progress of our country can be facilitated by a perfected credit system alone more attention has to be devoted to the study of the credit situation in our country. Cheap and easy credit ought to enable the agriculturists to become prosperous. As Sir Daniel Hamilton says, "the present vicious system of finance by the money-lender sterilises the beneficent work of the Government." Real, legitimate and productive credit should be created to ensure success in commerce, agriculture and industry.

Many more banks can be started without any detriment to the existing ones. The present joint-stock banks are of great value so long as they have plenty of resources and are ably and skilfully managed. The co-operative bank is an essential requisite for every village and more of these wonder-working institutions should be created. Other kinds of banks which provide cheap and effective credit have to be started and they will find their due place in a fully organised credit system of our country. Operations for a few years will enable them to consolidate their business and there will be a shaking-down into their clear-cut functional activities of the different kinds of financial institutions with which India may be blessed in the near future.

The saving energy of our people should be stimulated and directed into a broad stream of national finance. The extension of banking facilities and stock exchange and investing agencies of various orders, coupled with the ever-increasing publicity of the press and of telegraphic facilities for communication of news and transfer of payments, would increase the little dribblets of savings and turn them into a broad and navigable stream of finance which has to be carefully distributed over all parts of the country with increasing rapidity and accuracy of judgment. Our investors should send solid and concrete capital to tap every corner of our country to find natural resources for profitable exploitation.

The main function of our credit institutions is to stimulate and collect the savings of the people, call forth habits of thrift, economy and prudence, guide their outlay into productive channels and stimulate the productive activity of the people. Unless a wisely planned banking system exists developing the money power of our country political or social reform will be of no avail. Sir D. Hamilton correctly prophesies that "without a banking system which will develop the money-power of our country the reform scheme or any scheme becomes a dead letter and the new legislative council a farce." The development of the banking system is something which is incumbent upon us all as citizens of this country and it would be a patriotic act if we all registered a vow to enlighten ourselves fully upon our duties as citizens in respect of our understanding of the financial matters of the country.

A banker is not a mere parasite on the real owners and producers of a country. It is not the business of the banker to augment the capital of the country.¹ The Indian banker's sole duty is to stimulate private saving and its investment in interest-bearing securities instead of the present barren type of locking up cash in gold or ornaments. The banks have to create interest even in foreign securities. It is this movement that is going on in the United States of America as a result of which the Government bonds of the South American Republics and European countries are sold in the investment market. Even

¹ Adam Smith says, "all that the banker has to do is to make capital more active and productive than it would otherwise be the case. It is by this means alone that the judicious operations of banking can increase the industry of the country."—*Wealth of Nations*, edited by McCulloch, p. 257.

industrial securities like those of the De Beers Consolidated Mines are also absorbed by the American investors. German bankers similarly created this taste in the German public with the result that the pre-war German investments were to be found in Spain, Switzerland, Italy, the United States of America and South Africa. Even securities of Oriental origin were bought eagerly by the German investors.

An improved credit system can solve some of the currency ills of the country. The much needed elasticity in our currency system can be obtained. When once the issuing of notes is handed over to the Central Bank the note-issue will enlarge for more facilities for their encashment will be provided and as they become popular they would diminish much of the strain on the currency authority for more metallic currency. Banking extension makes for economy in metallic reserves so far as they are needed for domestic exchange. The highest currency ideal is to circulate a paper token instead of full-value metallic coins and the best way of approaching the ideal is to circulate bank notes. A wide-spread banking system would be an effective counterpoise to the hoarding tendency or unwise locking up of savings in the shape of gold or silver ornaments.

✓ *The Intelligent Guidance of the Central Bank.*

It is proposed to give a new turn to the banking wheel by the creation of a Central Bank of Issue and the present Indian money market can be perfected under its intelligent direction. The concentration in a single hand of the functions of the currency authority and credit-controlling duties of the Central Bank of Issue would render it possible to undertake more rigorous steps for the perfection of the Indian currency system. The control of credit should be so exercised that seasonal disturbances of exchange due to the export of staple crops or seasonal disturbances of currency due to the need for moving the crops are not tending towards disturbances in credit. The currency law must make adequate provision for due seasonal expansion of credit currency at such times and the Central Bank by virtue of its surplus reserve should always be in a position to satisfy the extra demands for credit.

Inaugurating a new era of closer co-operation and greater cohesion among the different banking institutions of our country and arriving at a common understanding of their mutual aims and better

realisation of their interests it should bring about unity where hitherto discord and jealousy have reigned triumphant. With the cessation of unfair and cut-throat competition among the different banking institutions of our country a glorious future awaits all our productive industries and the banks themselves are bound to reap their own share of profit. As they sow, so will they reap. The Central Bank itself should favour a continuous policy and with a broad basis of administration it should attempt to secure better co-ordinated domestic service on the part of the reorganised banking system.

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CHAPTER II

THE IMPERIAL BANK OF INDIA.¹

Introductory—Amalgamation of the three Presidency Banks—Constitution—Business outside India—Business in India—A balance sheet of the Bank—Its explanation—The Bank rate—Expected advantages of the amalgamated Bank—Its actual achievements—Its shortcomings—Some grievous misrepresentations—Dismantling of the Imperial Bank—Reconstituting the Imperial Bank—The future of the Imperial Bank.

Introductory.

The War no doubt brought to prominence many economic truths while it disproved some of the pet theories of economists. It left us quite a legacy of many difficulties, but it solved many important problems and opened the way for India to follow the practice of other countries in having some sort of centralisation in banking matters. From 1836 right up to 1919 the question of the formation of a Central Bank was mooted more than once² but was never brought to the region of practical politics either due to the apathy of the Government of India or the provincial jealousies standing in the way of the amalgamation of the Presidency Banks. Not satisfied with the possibility of developing the Imperial Bank of India into a Central Bank, the Hilton-Young Commission brought home to all parties concerned the utility of a central banking institution.

¹ The substance of this chapter originally appeared as an article on the Imperial Bank Scheme in the Indian Review, March, 1921.

² A brief history of the early proposals relating to the establishment of a Central Bank is given in Appendix II.

Amalgamation.

The present Imperial Bank of India¹ arose out of the amalgamation of the three Presidency Banks of Bengal, Bombay and Madras.² Though not the first banking amalgamation in our country, yet it was the most important one fraught with far-reaching consequences and pregnant with many possibilities. This amalgamation was quite a spontaneous thing, being the result of a natural banking evolution in this country. The recent war amply demonstrated the weak joints in our banking armour and the result of a lack of co-ordinated policy on the part of the various banks. Co-operation and co-ordination of policy for a short span of three years in order to finance the requirements of war, taught them the advantages of union, and the present amalgamation was only a consummation of that desire for they realised full well that there could be no true and effective co-operation without any formal amalgamation. Amalgamation was synonymous with strength and, anxious to retain the paramount influence which they wielded so long, they entered into amalgamation so as to preclude any amalgamated banking unit of the London Money Market from obtaining footing here and take advantage of the individual and isolated position of the three Presidency Banks. Alone and unaided no individual Presidency Bank would have withstood the strong and effective competition of the immigrant bank. As India stood in need of more loanable credit and the woeful want of banking facilities in the interior of the country was a well-known thing, this amalgamation strove to secure additional capital so as to extend banking accommodation and promote the healthy development of banking in the country. As some of the immigrant Exchange Banks were not British or Empire concerns there was a grave danger that non-British financial concerns might obtain undue influence and predominance in the monetary affairs of this country if the Presidency Banks were to remain isolated as before.³ If a close union of British and Indian

¹ A short history of the Presidency Banks is necessary for a correct understanding of the historical background. Hence their history is included in Appendix III.

² Though the Imperial Bank Act was passed in September, 1920, the Imperial Bank began conducting business on 27th January, 1921.

³ As in Canada there might be the American economic invasion and vast developments outside the influence of British capitalists might take place. For an idea of the present

interests could be secured by the amalgamated bank and if it were to open a branch in London just like the Dominion Banks of the British Empire the policy of co-ordination of finances of the Empire would become an accomplished fact.¹ Quite recently another link in this chain was forged by establishing an Advisory Committee to secure close liaison between the Bank of England and the Imperial Bank of India. In course of time closer contact would be established between the Secretary of State in Council and this Advisory Committee.

Constitution.

The total authorised capital of the Imperial Bank² consists of 225,000 shares of Rs. 500 each. The paid-up capital consists of 75,000 shares of Rs. 500 each of which Rs. 125 is paid. The reserve fund as on 31st March, 1928, was Rs. 5,12,50,000 and the reserve liability of shareholders amounts to Rs. 5,62,50,000.

To guard regional interests and to provide ample freedom in banking matters, the existing local boards of the Presidency Banks have been retained. A central board is created consisting of a general manager or two managers in the first instance, the Controller of Currency as the *ex-officio* Member of the Board, and the President and Vice-President of each local board, the Secretary and Treasurer of each local board who will have no voting power and four non-official members to be appointed by the Government to represent the taxpayers' interest.³ The Central Board is created to settle disputes

situation see the special article in the London "Times"—Canada Today—the American Invasion—Dec. 5th, 1927, p. 15.

¹ It was in January, 1918, that Mr. Goodenough outlined the advantages of Empire Banking significantly in the following words: "The extension of Banking organisation and the maintenance of fixed rate of exchange within the British Empire will give to our Dominions and Colonies a substantial preference and would serve to consolidate and promote trade within the Empire." A practical expression of this policy from the Indian standpoint might be this amalgamation of the Presidency Banks and their access to London, bringing about a close rapprochement between London and India. The present Barclay's (Colonial Dominion and Overseas) Bank can be taken as an attempt to organise an Empire Bank with the object of co-ordinating Imperial Finances.

² The older institutions had an aggregate of Rs. 37,500,000 of Capital and Rs. 38,000,000 of Reserve.

³ Representatives of new local boards may be added to the central board. There should be one local board instituted at each of the Clearing House centres—Rangoon, Karachi,

between the different local boards, if any should arise ; to look after the discount policy, to deal with matters of general policy, to determine the distribution of funds, to fix the bank rate and to publish the bank's weekly statements. The Central Board is to meet once in a quarter of an year at least alternatively at Bombay and Calcutta but a managing board is created which will meet more often and transact business. Full provision has been made for the exercising of adequate control by the Government as the Controller of Currency has power to hold up any action of the Board on any matter of vital importance affecting either the financial policy of the Government or the safety of its cash balances. The one peculiarity is the lack of any fixed location for the Central Board. Provision is made for its sittings alternately at Calcutta and Bombay. Judged by the experience of these eight years of its existence, the Central Board has not succeeded in initiating any useful line of development.

Business outside India.

The Imperial Bank has a branch in London to transact such business as may be entrusted to it by the Secretary of State for India, to rediscount bills of exchange for the exchange banks, to act as a custodian of the cash balances and to float sterling loans on behalf of Indian public bodies. It is not allowed to take up general foreign exchange business and compete with the exchange banks. While it is granted privilege to borrow money in the London money market on the security of its assets it is precluded from doing general banking business for all customers except the former ones of the Presidency Banks or its own customers in India. It has not been entrusted as yet with the task of floating and managing the sterling loans of the Government of India. From January, 1924, the London office of the Imperial Bank has been entrusted with the duty of managing the Government of India rupee debt in London which was hitherto managed by the Bank of England.¹ Generally speaking the policy of the

Cawnpore and Lahore. It is a matter of gratification to note that the framers of the Reserve Bank of India selected Rangoon and Lahore also as centres of its branches.

¹ For doing this service the Bank of England was paid about £500 per crore while the Imperial Bank is now paid only £300 per crore per annum with a minimum of £5,000 but if the balance falls below 8 crores in any one year, the commission is to be reduced to £4,000. It also keeps the account of the High Commissioner for India in London.

bank is to maintain practical equality of assets and liabilities at this branch. Quite recently an Advisory Committee has been constituted in London to guide the Imperial Bank's activities in the right direction.

According to the charter granted in 1920 the Imperial Bank had to increase the number of its branches by a hundred more within a period of five years and the Government had the option of nominating 25 out of them in places of their own choice. At the present time (31st December, 1928) it has 176 branches and the most important thing generally overlooked by the readers is its branch at Colombo. Although it is outside India proper there is no tendency on the part of the Imperial Bank to maintain a position of equality of assets and liabilities at this branch.

Business in India.

The Imperial Bank has been given the free use of the Government reserve treasury funds and the balances of the Government of India and the local Governments. The Imperial Bank manages the public debt work.¹ It does not however perform all the functions that the Bank of England does for the Government of the United Kingdom. There is a separate public debt office which acts as the actual registrar of the public debt. The Bank of England is the actual registrar of the debt. In the matter of floating Rupee loans on behalf of the Government, the Imperial Bank takes up a big block of it and sells it over the counter to the public. Individual subscribers to the Rupee loans may apply either to the Treasury or the Imperial Bank. Subscrip-

¹ The following remuneration is sanctioned for this work. A commission of Rs. 2,000 per crore per annum on the amount of the public debt on the books of the public debt offices excluding (a) Amount of loans discharged outstanding after one year from the date of notice of discharge, (b) Amount of currency investment, (c) Amount of stock certificates for five thousand rupees and upwards held by the Controller of Currency, (d) The amount of stocks and notes outstanding in the London Register. The bank is further allowed a fixed sum of Rs. 2,000 a year on account of the stock certificates mentioned in (c) above. If the bank manages the debt work of the local Governments the commission is Rs. 3,000 per crore. For managing the debt work of the Calcutta Port Trust and the Calcutta Corporation, it receives Rs. 3,500 per crore. Besides this fixed charge it also levies Rs. 100 per crore of loans for management, transaction of the business and for printing charges.

tions to the Government of India's sterling loans are dealt with on receipt of cabled advices from the bank's head offices in India.

The Imperial Bank transacts the same kind of commercial banking business which the Presidency Banks performed and some of its restrictions have been modified to a certain extent but their general nature has not been altered so as to permit unsafe business to be conducted. The following are some of the restrictions:—The Imperial Bank shall not make any loan or advance (a) for a longer period than six months, (b) upon the security of stock or shares of the bank, (c) save in cases of estates (court of wards) upon mortgage or security of immovable property or documents of title thereof. The amount which may be advanced to any individual or partnership is limited. Discounts cannot be made or advances upon personal securities given unless such discounts or advances carry with them the several responsibilities of at least two persons or firms unconnected with each other in general partnership. It cannot grant unsecured overdrafts in excess of Rs. 1 lakh. It cannot open accounts in the London office for persons other than its Indian constituents. The restriction of exchange business only to the *bona fide* requirements of its constituents however is a real practical limitation debarring it from a very profitable business. The other restrictions do not place very great disability on it. These do not seriously injure its profit-earning capacity and are of such a nature as can be safely imposed upon any other bank.

The banking business that it transacts is of the following nature:¹ —the receiving of fixed deposits,² and savings bank deposits,³ the collecting of deposits in the form of current accounts, the keeping of securities for safe custody, the buying and selling of gold and silver bullion or any other properties that might have fallen into the bank's possession in satisfaction of claims, the borrowing of money in India or London on the security of its assets, acting as administrator in winding up estates, transacting agency business on commission, the investing

¹ The Imperial Bank pays 3 per cent. on ordinary Savings Bank deposits and 3½ per cent. on Savings Bank deposits of Rs. 10,000 and above fixed for three months. On account of the payment of interest the S. B. deposits increased from Rs. 412 lakhs at the inception of the Bank to 1,079 lakhs on 31st March, 1925.

² These are of two classes:—(a) those repayable at the end of 7 days' notice and (b) those repayable at the end of six or twelve months.

³ See Part I of Schedule I of the Imperial Bank of India Act.

of its funds in authorised securities such as trustee securities, securities of Government guaranteed railways, debentures issued by the District Boards and Government securities; the drawing, accepting, selling and discounting, buying and selling bills of exchange—payable outside India for and from or to such banks as may be approved, the issuing of letters of credit and bank post bills payable in India and in Ceylon and lastly the drawing of bills of exchange and the issuing of letters of credit payable out of India for the use of their private constituents for *bona fide* personal needs and buying for the purposes of meeting such bills and bills of exchange payable out of India at any instance not exceeding six months and the granting of advances in the form of loans, cash credits and overdrafts, and the making of inland transfers from one branch to another on behalf of their customers. Thus it does general banking business like the Commercial Banks. Like the State Bank it acts as the Government Bankers conducting treasury work at its branches, and like the Central Banks of other countries it acts as the banker's bank, and all leading banks deposit their balances with the Imperial Bank and it undertakes clearing house work where there are clearing houses.

*The Balance-sheet of the Imperial Bank of India as at
16th March, 1928.*

<i>Liabilities—</i>				Rs.	A.	P.
Subscribed Capital	...	...	...	11,25,00,000	0	0
Paid-up Capital	...	...	...	5,62,50,000	0	0
Reserve	...	...	...	5,12,50,000	0	0
Public deposits	...	...	...	6,01,40,000	0	0
Other deposits	...	...	...	71,30,29,000	0	0
Loans against securities <i>per contra</i>	...	...	...	.....		
Loans from the Government of India under Sec. 20 of the P. C. Amend- ment Act against bills discounted and purchased <i>per contra</i>	...	...	...	8,00,00,000	0	0
Contingent liabilities	...	...	...	.....		
Sundries	...	...	...	70,01,000	0	0
TOTAL				96,76,70,000	0	0

			Rs.	A.	P.
<i>Assets—</i>					
Government securities	...	...	18,55,29,000	0	0
Other authorised securities	...	...	2,03,38,000	0	0
Loans	...	...	14,19,35,000	0	0
Cash credits	...	...	32,86,78,000	0	0
Inland Bills discounted and purchased	...	...	14,01,17,000	0	0
Foreign Bills	...	...	41,79,000	0	0
Bullion	...	...	.....		
Dead stock	...	...	2,78,66,000	0	0
Liability of constituents for contingent liabilities <i>per contra</i>	...	...	.....		
Sundries	...	...	38,03,000	0	0
Balances with other Banks	...	...	1,85,000	0	0
			85,26,30,000	0	0
Cash	...	...	11,50,40,000	0	0
			96,76,70,000	0	0
TOTAL					

The above balance sheet includes—

Deposits in London	...	£ 904,100
Advances and Investments in London	£ 990,600	
Cash and Balances ^s at other Banks in London	...	£ 12,600

Percentage—13·37

Bank Rate—7 per cent.

Explanation. On the liabilities side the paid-up capital refers to the portion of the total capital on which the credit of the bank rests and it represents the solid capital which the share-holders have paid up. The 'reserve' relates to the reserve fund of the Imperial Bank. 'Public Deposits' are the deposits of the Government for which the Imperial Bank pays no interest. At the time taxes are gathered public deposits increase. 'Other deposits' are those of the Exchange Banks, the Indian Joint Stock Banks, the semi-public corporations, traders and customers of the bank in its ordinary banking

business. These indicate the strength of the banking¹ system. The Imperial Bank does not pay interest on current account but pays interest on "fixed deposits on sums not below Rs. 500." "Loans against securities *per contra*" are usually borrowings of the bank against some of its authorised securities included in the assets side of the balance-sheet. Loans from the Government of India under Sec. 19A of the Paper Currency Act represent sums borrowed on the internal bills of exchange or hundies drawn during the course of trading transactions in order to secure easiness of credit in the money market. 'Sundries' means miscellaneous liabilities.

Coming to the assets side Government securities mean the Bank's investments in Government loans. 'Other authorised securities' refer to the holdings permissible under the Act. The State-aided and District Board Railway securities and securities of the Port Trusts and the Improvement Trusts can be held and broadly speaking the proportion of the Government securities to the total is approximately four-fifths.

Loans and cash credits refer to the Bank's advances to its customers on securities placed in its hands. "Bills discounted" relate to the purchase of hundies and internal trade bills. Big loans are usually granted on gold both by the Imperial Bank and the Exchange Banks. When the price of gold is fluctuating the speculative buyer of gold always counts on the possibility to sell the gold within the ten days that are usually granted for payment by the Exchange Banks which import the gold bars. If it is not sold in the market within this period a loan is negotiated and thus Indian banks usually lend on gold. Sometimes loans are granted to its constituents in London against securities held in India.

The Imperial Bank grants cash credits at moderate rates more generally at the prevailing bank rate to the Provincial Co-operative

¹ An idea of the relative proportion between the two kinds of deposits can be gained by the following table :—

Year	Public Highest	Deposits Lowest.	In lakhs of rupees.		
			Banker's Highest	balances Lowest	
1921	2417	401	3751	1751	} See Norman Murray's Evidence, Vol. IV, p. 479.
1922	3919	571	2453	664	
1923	2974	623	2931	465	
1924	3193	787	1507	193	
1925	2896	430	1397	192	

Banks. In this way the Imperial Bank is financing agriculture through the co-operative societies. The signature of two approved parties is insisted upon and the cash credit is extended to a period of six months.¹ The cash credit though not so self-liquidating as the trade bill, is repayable at a very short notice, say a week, and in effect a portion of these can come under the same category as trade bills. It is the practice of the Imperial Bank to curtail cash credit facilities if it thinks that the stock of goods was going up during the past six months. Cash credits are granted usually against self-liquidating assets and not for locking up the bank money in securing fixed capital such as installation of machinery and repaying of capital debts. Theoretically at least they are repayable on demand and can be called up at any time the bank wants to.

Sometimes 'manufactured bills' are substituted for these cash credits in order to place them in the P. C. Reserve and secure additional note issue according to the provisions of the P. C. Act. But the Imperial Bank was decidedly against this creation of bills, for it was put to definite loss on account of stamp duty to be attached on the hundi at the rate of Rs. 9 per Rs. 10,000. Cash credits were granted on promissory notes bearing 4 *as.* stamp and the Imperial Bank had to pay the heavy stamp duty to induce firms hitherto financing themselves by cash credits to finance themselves by drawing bills. The Government had to agree to reimburse the Bank the cost of this duty, for additional note-issue can only be obtained by placing hundies or issuing notes on treasury bills put into the P. C. Reserves in London. The Government was disinclined to tie up their resources in London by placing Treasury bills in the P. C. Reserve to a greater extent than it was compelled to do. Hence it was often arranged as a result of compromise between the Imperial Bank and the Controller of Currency to secure hundies and issue additional notes on these hundies.

'Foreign bills discounted' means the purchase of the foreign bills for its customers only and its sterling purchases average roughly about £6 ms. sterling annually. The average maturity of the inland or

¹ An overdraft account on the basis of a cash credit agreement is generally entered into with trading companies on the security of the pledge of goods and merchandise. In pursuance of such agreement the trading firms pledge goods and secure the needed finance from time to time.

domestic bills would be about 60 days while the maximum maturity is 90 days. Nothing definite can be stated as regards the average maturity of overdrafts granted by the Imperial Bank.

'Bullion' refers to the gold and silver stock held by the Bank.

'Dead Stock' refers to buildings, furniture and movable property owned by the Bank. 'Balances with the other banks' are the accounts opened with other banks to facilitate collection and payment of cheques. "Cash" refers to the amount of cash in hand. This item is important and its proportion against the outside liabilities, *viz.*, the deposits, loans and sundries is expressed as percentage at the foot of the balance-sheet.

The Imperial Bank finances internal trade to a great extent and some of the big industrial companies are also financed by it.¹ The advances on hundi business are made to the shroffs who in their turn advance money to the outlying places. The Madras branch finances the Natukottai Chetties who finance the Madras and Burma rice crop to a large extent and the trade of Burma with Ceylon, South India and Siam is in their hands. The financing of industries is usually done by—(a) Clean loans which are granted on pro-notes signed by two persons and on a personal guarantee of some of the share-holders of the concern. This is how cotton-spinning and jute mills are financed. (b) Produce loans which are granted on country produce stored in the godowns under the Bank's own lock and key. Sometimes the Imperial Bank may discount 'hand bills' for approved customers and these are pure finance bills. The Imperial Bank never finances growing crops except by means of granting clean loans on the personal guarantee of two persons. As a matter of practice the Bank advances on grain, produce, etc.; these loans are usually made at 8 to 9 per cent.

The Bank Rate.

The bank rate indicates that the Imperial Bank is prepared to lend money on Government securities at that rate.² The bank rate is

¹ "It lends occasionally on mortgage as primary security and initiates the loaning transaction when the primary security is a mortgage." See Mr. A. Bowie's Evidence before the Hilton-Young Commission (p. 102, Vol. II). This is more an exception that proves the rule. As a matter of practice its loans are generally well-secured.

² It should not be mistaken for the Hundi rate for this is only the rate at which first class Hundies maturing at the end of 60 or 90 days are discounted for the shroff, by the Im-

usually higher in winter and early spring ranging from 6 to 8 per cent. and low in summer, say 4 to 5 per cent. On the whole the average rate is not high but it rises to a high maximum during the busy season. When the demand for money is great the rate rises indicating that it is transacting considerable volume of business. During the slack season, although the bank rate is nominally low, it is willing to lend money at a still lower figure.

The most noticeable feature of the bank rate is that the Imperial Bank does not effectively control the money market just as the Bank of England controls the money market in London. Again the expected lowering, levelling up and equalising of the extremely high rates that prevail for banking accommodation in our country during the busy season has not been realised. The ideally low bank rate of France or Germany or England has not been reached.¹ Of course this is due to the government borrowings either in the way of short-dated Treasury bills or permanent loans for longer periods. Unless it gives up long-term borrowing there would not be the possibility of collecting surplus cash in the hands of the Imperial Bank and a lowering of the bank rate. Of late a more judicious policy in the matter of floating Treasury bills is being pursued and with a better understanding between the money market and the Government substantial benefits can be secured by both parties. The seasonal swings² for currency are no doubt responsible for seasonal fluctuations in the Bank rate, but still the prevailing high rate of discount is chiefly due to the insufficiency of capital in the country. The difficulties of the

perial Bank. The Imperial Bank's Hundi rate is again different from the bazaar rate, i.e., the rate at which the indigenous banker discounts the Hundis. For a greater portion of the year there is a "considerable spread" between the Hundi rates quoted by the Imperial Bank of India and the indigenous bankers or shroffs.

¹ The average bank rate in 1921-1925 was as follows :—(See 12th issue S.T. Relating to Banks in India, p. 9).

Year.	First half, ending 30th June.	Second half, ending 31st December.	Yearly average.
1921	6.04	5.11	5.57
1922	7.13	4.51	5.81
1923	7.42	4.50	5.96
1924	8.05	5.32	6.68
1925	6.58	4.20	5.64

² During the marriage season, holiday season and holy season there is a great demand for currency.

cold-weather finance during any year generally arise solely if the exports such as jute, hessians and cotton are to be sold at a high price and great funds would be required to move the export crops to the ports. Whenever crops move in their streams and the produce is low-priced there would be no tightness in the money market. When trade is brisk, crops are heavy and the produce is high-priced there would be tightness of money in the market. Inter-bank call money rate would rise. The percentage of the Imperial Bank's cash reserve would fall. Exchange itself would become lively and the different financing agencies get brisk business. Bank rate has to be screwed up. If at that time the political situation in this country continues to be disturbed it would act as a bar to the free export of capital from the United Kingdom to India.

Expected Advantages.

Though the glorious vision of a great State Bank ¹ subserving the interests of the public and rendering equally meritorious service to the other banks doing business in the money market, which Sir M. Hailey ² invoked was not realised, yet certain advantages have flown out of its actual working during these years.

The General Public.

The general public would stand to gain much by the popularising of the banking business. The opening of branches of this quasi-government bank with its single and unified management would inspire confidence among the people and inculcate the banking habit gradually. Though there may be no "sudden miracle" brought about by the creation of a banking habit yet it is an indispensable preliminary for making people believe in the utility of the banking institutions.

The staffing of the innumerable branches of the Imperial Bank requires men trained in modern methods of banking and this stimulates very considerably the training and employment of Indians as

¹ See the Government Despatch to the Secretary of State for India on the Imperial Bank proposal.

² See his speech in the Legislative Assembly on the Imperial Bank Bill—Sep., 1920.

bankers. Thus a banking career is to be created shortly which may afford relief to the already overcrowded professions of the present day. More of these sound and trained bankers may lead to an improvement in the banking standard of our country.

The Customers of the Bank.

The advantages to the customers of the Imperial Bank will also be of a weighty character. With the fuller utilisation of the government balances and a more elastic use of them and with more increased working capital the Imperial Bank can reduce the present high discount rates prevailing during the busy season. A steady, uniform and cheapened rate will be the result and it will be a great stimulus to agriculture and commerce in our country. A proper and wise distribution of capital will be another inestimable blessing. The opening of a branch office in London will lead to a closer touch with the London Money Market which is the well-known hub of international commerce. It may lead to the obtaining of trustworthy information regarding concerns in England interested in Indian trading. Again sterling loans can be arranged for local bodies and investments made in British securities through its branch in London. A largely increased number of branches and the ability to discount more hundis and trader's bills means that the Imperial Bank will be in a position to render yeoman's service in irrigating the channels of internal trade.

The Government.

The Government of India stands to gain much by the successful working of this bank. Millions of rupees locked up in the reserve treasuries during the busy season usually caused a tightness and stringency in the money market.¹ The reserve treasuries have been

¹ This can be illustrated from the Bank of Bengal's rates of discount which were altered according to the cash reserves of the Bank and the demand for discount.

Year.	Minimum.	Maximum.	Year.	Minimum	Maximum.
1877	7½	14½	1883	7½	10½
1878	5½	11½	1900	3	8
1879	6½	11½	1907	3	9
1880	5½	9½	1910	3	6
1881	5½	10½	1912	3	8
1882	6½	12½			

abolished and the Imperial Bank will transform these immense sums of money from mere warehouse merchandise into an active banking power. The Government has undertaken to discontinue the issue of currency transfers to the public between any two places in which a local head office or branch of the Imperial Bank is situated. The Imperial Bank is entitled to transfer its funds through currency free of charge and in return has undertaken to give the public every facility for the transfer of money between the local head office and branches at rates not exceeding a maximum approved by the Controller of Currency.¹ This means that the Imperial Bank will be responsible for the movement of funds in India and also of making them available to the Government whenever and wherever they are required. This will lead to the opening of more branches and due provision is being made in this direction. The reserve treasuries which hitherto existed acted as a buffer receiving the first shock. Now that they have been abolished the Government's demand would be made on the balances deposited in the hands of the Imperial Bank. This necessitates the keeping of a higher proportion of cash to liabilities than now so as to meet all sudden and large demands, but the mere concentration and pooling of reserves will lead to efficiency and economy of the reserves and adequate business accommodation.

The decentralisation of the public debt work hitherto concentrated in the Calcutta Offices will improve the administration of the public debt and will encourage small investors of the interior to go in far more frequently for Government securities than is the case now.

If the management of the balances of the Secretary of State and this banking and remittance business were to be performed by the Imperial Bank's branch office in London it would save him a lot of

¹ The following are the rates approved and these are uniform throughout India and Burma for all telegraphic transfers or drafts issued by the Banks :

For sums of Rs. 10,000 and over.....	1 anna per cent.
„ „ „ 1,000 and below Rs. 10,000.....	2 annas „
„ „ below 1,000.....	at the discretion of the Bank

Vide Report of the Operations of the Controller of Currency for the year 1920-21,

p. 32.

Quite recently in order to help the banks to take advantage of this business the charge for banks for amounts over Rs. 10,000 was reduced to $\frac{1}{2}$ anna per cent. The public have been making an increasing use of this concession. See Appendices X and XI attached to the Memorandum submitted by Mr. A. C. McWatters to the Hilton-Young Commission.

carping criticism by the unenlightened public. As Sir James Meston remarks, "it would relieve the officers of the Government who very often have neither the training nor experience necessary for this sort of work of obligations and the responsibilities for which they themselves must recognise that they are not fully equipped." It will enable the Government of India to float loans at a low rate of interest during summer months.

The Imperial Bank.

The advantages to the Imperial Bank itself are no less marked. It enjoys the proud and privileged position of a bankers' bank. Neither a purely European banking institution nor a purely Indian bank, however successfully they may conduct their business, have any bright future before them. They can never shoulder such immense burden as the extension of banking facilities to the interior of the country. A united stand of the European and Indian people is essential. Such a thing is brought about by the Imperial Bank. On account of its increased resources and with the Government behind it the Imperial Bank can successfully play the part of a bankers' bank. It can become a sanctuary to the struggling banks. By virtue of its capital and massive size it will soon obtain controlling influence and be the responsible leader in times of emergency. The successful working of the Imperial Bank will convey to the minds of the general public a sense of ease and security hitherto wanting in periods of stress and will make the Imperial Bank a bulwark of public confidence. Access to the London Money Market has been granted and some of the restrictions are relaxed.

Such are the manifold advantages that promise to flow out of a successful working of the Imperial Bank. *But it has to realise its duties.* It has to bear in mind that "a central bank is a great note-issuing institution in which is vested to an extraordinary degree the financial responsibility of a nation in that its methods enable it to supply at all times an elastic currency varying automatically with the needs of the country, to maintain an adequate gold reserve through the regulation of foreign exchange and to conserve and protect the country's metallic reserves, to control the money market by its regulation of the discount rate and to serve as a sanctuary for all banks in

periods of threatened danger." The task of watching the general stock of gold, the repressing of the tendencies towards an undue expansion of credit and expanding currency so as to supply the needed amount to meet the demands of trade, are the functions and onerous duties performed by the national banks of foreign countries. The Imperial Bank should realise that as a national bank it has to keep an eye on national interests. It should not be a purely profit-seeking institution. It should protect and safeguard the general financial situation of this country always. In order to become a Central Bank it has to make these necessary sacrifices. It should not compete with the other banks. If it were to do so with its far larger resources and special privileges from the Government it would incur their resentment and hostility. It should on the other hand be their refuge in times of panic and trouble.

The advantages to the joint-stock Banks have also to be reckoned. The Imperial Bank can guide the banking policy as a whole and be their guide, friend and philosopher. It can rediscount their bills and satisfy their wants for more credit currency. Co-operation and co-ordination of the several banking institutions will lead to better resistance in the time of a crisis and a solid and united front under the leadership of the Imperial Bank will be an effective protection against foreign influences. The Indian banking system will be welded into a co-ordinated whole. It may probably lessen the profits of the other banks holding large reserve deposits but in the security from the operation of the Imperial Bank and in greater stability of business, greater activity and mobility of reserves administered by it the banks would have protection that would be more than a set-off to any diminution of profits.

Coming to the Exchange Banks it can be confidently predicted that they too will reap their own share in common prosperity. Now that competition in the matter of general exchange business has been eschewed altogether there is no ground for resentment. Their bills will be rediscounted in London and India, thereby enabling them to send back money to India quickly and be in a position to make further purchases of export bills in India.

The Co-operative banks will gain much by the successful working of the Imperial Bank. The duty of rediscounting agricultural paper will be taken up by this bank and thus it is to act as an apex bank

rediscounting paper of the smaller banks. In short it can become the central rediscounting agency. The Government by virtue of its handing over its reserves and balances and entrusting it with the privilege of issuing notes, hopes to create a central financing agency looking after commercial, industrial and agricultural interests.

Hitherto it has been said that interprovincial jealousies, the large extent of our country and the impossibility of securing capable directors would stand in the way of a central bank. In the present case local boards are given full freedom in their respective spheres while at the same time an effectively controlling central board has been instituted. The question of Government help has been happily solved. But the Controller of Currency should be alert always and hold up action when the interests of the public are threatened by a misuse of its money. On the other hand, he should not make the bank a servant of the Government. Independence of the banking power is essential and should be preserved at all costs. The supposed fear that competent men would not be available to manage the amalgamated bank has been entirely disproved, and as the proverb puts it "the occasion and the hour always brings forth the man."

Its Actual Achievements.

While such were the advantages that were expected to flow out of its successful functioning it is the duty of the bank historian to record its actual achievements. If, in order to apply a technical test to the observation that it succeeded so well as to be accounted a memorable achievement, we study the Indian money rates as they ran both before and after the amalgamation we can notice some transformation indeed. First the undue spread between the different rates, i.e., the Imperial Bank Hundi rate and the Bazar rate, has been much reduced and at least in the Bombay market it is being systematised. Next whereas before the amalgamation there was a differential between the Madras money rates and the Bombay and Calcutta money rates these irregularities have been ironed out and levelled. And lastly whereas before the amalgamation the seasonal swing of business carried with it correspondingly sharp fluctuations in money rates throughout the year these have been reduced and a new elasticity in the credit system has been obtained by the seasonal expansion of

emergency paper currency according to the terms of the Paper Currency Amendment Act of 1923 and subsequent changes in the procedure, through its channels. This reduction of rates, by itself, is a notable contribution which the Imperial Bank has rendered to the business stability of this country.

Opening its branches in the interior of the country it is slowly expanding its field of usefulness and is bringing within easy reach of all sound banking facilities. The Imperial Bank recently opened a large number of pay offices during the first half of 1927 in the grain districts of the Punjab and the United Provinces. This shows that the Imperial Bank is alive to the necessity of progressive expansion without any direct Government pressure being exerted in favour of branch development and several of them are established in places where banks or branches of banks do not exist. Since the liquidation of the Alliance Bank of Simla the Imperial Bank has been trying to cover some of the abandoned ground.¹

It exercised an "imperial outlook" and wide latitude of vision when it promised to help the Alliance Bank of Simla but the evils were too deep-rooted to be remedied. Its help to the creditors of the Alliance Bank of Simla was undoubtedly due to the initiative of the Government of India and it cannot be taken as a precedent that would be followed in case of all bank failures. It did nothing to save the depositors from the disaster arising out of the failure of the Bengal National Bank. But it has always acted as a sanctuary to the troubled Banks in times of a "run." When the Alliance Bank of Simla was closed there was a run on the Tata Industrial Bank and the Bengal National Bank.² The Imperial Bank promptly assisted them. Similar help was given to the Central Bank of India when there was a run on its Bombay and Calcutta offices during 1926. It acted as an element of strength to these Banks during the hour of their trial.

Merchants and traders are making increasing use of the improved facilities for internal remittance. The transfers of money from its local headquarters to its branches were affected at rates fixed by the

¹ See the Evidence of Mr. A. Bowie before the Hilton-Young Commission.

² See Mr. B. Chakravarty's speech at the Annual Shareholder's meeting of the Bengal National Bank held in 1923. See also his oral evidence, before the Hilton-Young Commission, Vol. IV, pp. 392-400.

Controller of Currency which were originally one anna for amounts of Rs. 10,000 and over. Owing to reduction in these charges an increasing use is made of such facilities. Before long a day may arise when there will be no charge made for internal remittance through the agency of the Imperial Bank.

The Imperial Bank has developed close relations with the apex Provincial Co-operative Banks of the different provinces and overdrafts are allowed. Ordinary joint-stock Banks also maintain close relations with the co-operative banks as in the case of Germany¹ and Italy. Until such close relations are maintained it would be impossible to make adequate provision for all the credit requirements of the agriculturists.

It again launched out a bold policy of helping the Indian small and middle class investors so as to enable them to subscribe to the 1928 Rupee loan floated by the Government of India. As eighty per cent. of the loan subscription is to be paid by the Imperial Bank of India on behalf of the customer-subscriber, the customer would be getting a Government bond carrying five per cent. interest and, as he would be paying four and a half per cent. on the loan amount to the Bank, the real rate of interest to the subscriber would be nearly ten per cent. on the actual money he loans to the Government through and with the help of the Imperial Bank.

Its Shortcomings.

Nevertheless, if we push our investigations a little deeper so as to penetrate behind this attractive and imposing facade a different condition of affairs begins to reveal itself. *It was expected that the Imperial Bank would rise to the full dignity and stature of a Central Bank.* Acting as the depositary of the cash reserve of the other banks, performing more business with the banks than with the outside public, thus justifying, in reality, the term bankers' bank, relaxing the loaning policy to some extent, realising that it is the handmaiden of trade and industry of our country whose imperative duty is to fulfil its

¹ The Dresdner Bank acts as an apex Bank for the powerful Schulze-Delitzsch unions and the agricultural unions based on the Raiffeisin principles. It maintains a separate co-operative section to conduct this business.

ever-changing requirements, earning less for profits than is the case at present, developing to a certain extent the newly permitted acceptance business, organising a discount market and rendering help to all sound banks in their occasional hours of distress, the Imperial Bank can obtain real control in the money market and uninfluenced by political currents or other members of the banking community it should conduct the whole machinery of banking in the wider national interests of the country. *It was a complete disregard of this advice that has led to a scathing indictment of the Imperial Bank's policy.*

On the banking side the Imperial Bank does certainly compete with the Indian joint-stock banks and it has always been a bitter source of complaint on the part of the joint-stock banks.¹ The general public however stands to gain out of competition between these banks in its fullest form.

It has not done much in the direction of training Indian apprentices to responsible offices and Mr. B. M. Das says it continues to be an "entirely European-controlled and European-managed institution."² The superior posts are not wholly filled up by European employees recruited from the London joint-stock banks thus depriving Indians of an equal opportunity to get themselves trained in banking business. A close perusal of Mr. Norman Murray's figures shows that invidious racial discrimination does not exist but the tabooing of all questions relative to the Imperial Bank's management by the members of the Legislative Assembly has rightly or wrongly created suspicion against the Imperial Bank.

¹ See the oral evidence of Mr. A. Bowie before the Hilton-Young Commission, Vol. IV, p. 93. "Placed above economic competition by virtue of its character as a quasi-state bank" it has begun to compete with the indigenous joint-stock banks that have been left "powerless to withstand this competition. The exchange banks are however free from this economic competition on the part of the Imperial Bank..." This indictment is undoubtedly an interested piece of criticism but judging from the wider national interests of the country as a whole this movement has to be welcomed and if it were to open branches in places not covered already by the existing banks there would be no scope for this criticism even. See the oral evidence of the witnesses representing the Bengal Chamber of Commerce before the Hilton-Young Commission.

² See the written evidence of Mr. B. M. Das before the Hilton-Young Commission, Vol. II, pp. 412 to 414. A perusal of the figures given by Mr. Norman Murray to the Hilton-Young Commission states plainly that on 31st December, 1925 about 70 Indians have been placed in charge of branches, sub-agencies, pay-offices or out-stations.



Thirdly, it failed to create a powerful body of private banks round it. One of the objects of the amalgamated Bank was to create a central rediscounting agency. But there are not very many bills drawn even now and an open discount market¹ does not exist where the bills can be borrowed upon. Nothing substantial has been done in the perfection of this most important form of negotiable credit.

Nextly, the percentage of cash as against its liabilities falls to a dangerously low proportion and often for several weeks the proportion would be 12 to 15 per cent. and the rigidity of our credit structure becomes too apparent at such times.

Fifthly, the Imperial Bank has not adopted the salutary practice of appointing local people to help the branch managers in the matter of discounting bills. The Lucknow branch of the Imperial Bank would have avoided much loss if it had been helped by such a local advisory committee. Even now it is not too late to mend matters and in all important centres of trade the institution of such bodies is a desirable step in the right direction. T. Joplin² pointed out the advisability of this step long ago and recommended the placing of every branch under a board of local directors chosen from commercial and industrial people of the locality.

Finally it failed to rise in opposition to the Government when it was undertaking functions in disregard of the general interests of the country. Mr. Gubbay, one of the fathers of the amalgamation scheme, says that "one of the possibilities I had in mind when this was created was that the Finance Department of the Government of India should be strengthened by being able to say in regard to any suggestions on questions of banking or finance or exchange or currency from outside that they had the control and regulation of the financial arrangements in India. I said to them: It is bound to occur that the Governor and the *Managing Governors of the Imperial Bank will have to stand up to the Government, if they think that the Government are taking steps which they regard as likely to endanger*

¹ See M. L. Tannan, "Banking Law and Practice in India," p. 227.

² See "An Essay on the General Principles and Present Practice of Banking in England and Scotland" by T. Joplin. The Big Five of London keep consultation committees of former directors of amalgamated banks to grant advice to branch managers.

or to be inimical to the general requirements of the country. I say of that function of the Imperial Bank I have seen no evidence whatsoever that it has been or is being discharged."¹ It never enabled the Government to develop a correct policy in encouraging the use of hundis and internal bills of exchange.

Some Grievous Misconceptions.

A recent writer,² who does not evidently make a proper use of statistics, attempts to prove that the Imperial Bank of India has not succeeded in increasing the deposits attracted by it. He resorts to the deposit figures of 1920 to prove his contention. He fails to notice that 1920 was a boom year and inflation of deposits was the prevailing tendency of that particular year. The proper thing would have been to take a chain of five years from 1915 to 1919 and compare the deposits with those of 1921 to 1925, another period of five years. As the Government developed the habit of depositing their balances and loan subscriptions in the hands of the Presidency Banks during the first period it would not be unjustifiable to compare it with the second period. Taking the first and second period the growth of *private deposits* was as follows:—

<i>1st period</i>	(lakhs of Rs.)	<i>2nd period</i>	(lakhs of Rs.)
1915	... 3861	1921	... 6577
1916	... 4470	1922	... 5700
1917	... 6771	1923	... 7419
1918	... 5097	1924	... 7671
1919	... 6821	1925	... 7783
Total for five years	... 27,020	Total for five years	... 35,150
Annual Average	... 5404	Annual Average	... 7030

¹ See M. M. Gubbay's Oral Evidence before the H. Y. Commission, Vol. V. p. 116. (Italics are mine.)

² B. T. Thakur's "Organisation of Banking in India," pp. 55 and 56.

Even if the "moving average" is taken into consideration it cannot be held that the deposits are declining. It is clear that "the contention that the commercial public is finding services of other banks more suitable" cannot be held until it is clearly proved that they are attracting more than what the Imperial Bank has been able to do. The fact that other joint-stock banks can pay even the current accounts should not be forgotten in this connection:—

		Deposits of the Exchange Banks in India. (lakhs of Rs.)		Deposits of the Indian Jt. St. Banks. (lakhs of Rs.)
1st period	1915	... 3354 ...	...	... 1878
	1916	... 3803 ...	...	... 2572
	1917	... 5337 ...	...	... 3216
	1918	... 6126 ...	...	... 4214
	1919	... 7435 ...	...	... 6127
2nd period	1921	... 7519 ...	...	... 8015
	1922	... 7338 ...	...	... 6501
	1923	... 6844 ...	...	... 4769
	1924	... 7063 ...	...	... 5517
	1925	... 7054 ...	...	... 5790

The annual average for the first period is as follows:—

The Exchange Banks ... 5211

The Indian Jt. St. Banks... 3601

The annual average for the second period is as follows:—

The Exchange Banks ... 7163

The Indian Jt. St. Banks... 6118

It is also true that the 18 Exchange Banks, that have been attracting deposits in India, have put up a higher average deposit but it

must be remembered that they pay current account deposits even. But even these have not progressed to such an extent as the Indian Jt. St. Banks have done in the second period of our study.

A second misconception that is in the minds of the general public is that the state is not exacting any *quid pro quo* for the deposits it is entrusting into the hands of the Imperial Bank of India. The grievance is that the state does not participate in the profits of the Bank arising out of the banking use of its deposits by the Imperial Bank. The services that the Bank is rendering are very often forgotten in this direction. The Imperial Bank does the Treasury business which entails heavy work and a good deal of expense. The prestige of being the banker of the state indirectly attracts deposits. It is inevitable that one bank or other should be selected and although that selected bank should pay something in return for the free use of state balances¹ too unfair use is being made out of this single argument. Restrictions interfering with the work, though not the policy of the Imperial Bank, have been laid down. The Bank is entangled in somewhat fantastic statutory provisions.

It is undoubtedly true that it has tended to become a State Bank in the narrowest possible meaning of the term. It has failed to become a genuine Central Bank cheapening credit and commanding due respect from all parties. It has been handicapped however in this important respect by its own charter. The two serious limitations are lack of control over the issue of paper currency and lack of power to deal in general foreign exchange business at least to facilitate the remittances of the Government of India from India to England. If once it loans up to its full limit during the busy season it has no further power to expand the currency beyond the twelve crore limit. Hence arises its failure to cheapen credit during the busy season.

The Dismantling of the Imperial Bank.

It has been suggested that the Imperial Bank of India should be dismantled and in its place a new organisation based on the model of

¹ The Imperial Bank certainly secures a decent return out of the use of state balances and it is also true that a large part of the working capital of the Bank is due to the cash balances of the state.

the Federal Banking system of the United States of America should be started in this country with the Reserve Bank as the Central Bank and pivot of the whole banking system. It is proposed to dissolve the Imperial Bank and revive the old Presidency Banks in the Presidency Cities without branches in the interior. Below them district banks should be created in each district and all these three constituents should be federated into one entire structure. While the Reserve Bank would be the Imperial Government's banker the Presidency Banks would be obtaining the work of the Provincial Governments and the District Banks the work of these Governments in the mofussil areas and all Government Treasuries should be abolished. Lest Government funds might be mismanaged it is proposed to make it compulsory on the part of these Banks to earmark a certain amount of minimum funds to promptly repay the Government balances. Such local banks dealing with local needs would be enabling the flow of capital from province to province when the Bank Rate of the latter rises. Diversity of economic conditions and trade requirements necessitate the maintenance of separate bank rates for the different parts of the country and one uniform rate all over the vast sub-continent as is now maintained by the Imperial Bank is positive discouragement to the free flow of capital from one province to another province.

Although there is some amount of truth in this criticism yet the maintenance of a federal system of banking¹ would not be the panacea for our banking ills. This scheme is fraught with certain dangers. The rights and privileges of the share-holders of the Imperial Bank would have to be duly safeguarded. It would introduce great disturbance in the money market. The management of the different district banks might not be conducted on sound lines.

¹ Even in America there are many people who are questioning the ability of the F. R. Banking system in controlling credit. Even there it is admitted by experts that it has not proved a complete success and there are some who have already prophesied that the Federal Reserve system would be abolished at the end of the term of the present charter. Both in 1926 and 1927 about 956 member banks failed in each year. The F. R. Board is easily subjected to political influence. There are too many independent local banks which can pursue a liberal policy of credit and the F. R. Banks would be unable to check the credit situation. See the Evidence of Dr. Sprague before the Stabilisation Committee—House of Representatives, 7895, 1927, pp. 403-413. Quoted by the Hon'ble George Peel in "The Economic Impact of America," pp. 304 to 309.



Though the Government might be the connecting link in the banking chain of this federal type yet there is not the likelihood that the Reserve Bank's voice would be immediately felt throughout the system. A scientific credit control or the joint control of credit and currency would then become impossible. It is not mere numerical increase of banking institutions that is the chief desideratum at present. The whole swarm of the District Banks might pursue a 'liberal' policy of expansion as they would be susceptible to the pressure of making profits.

Reconstituting the Imperial Bank.

There are several people who dream of the possibility of raising the Imperial Bank to the status of a Central Bank so that the problem of reconstructing the Imperial Bank would resemble a great office-building changing its antiquated structure and substituting in lieu thereof steel and marble, yet accomplishing it all without serious inconvenience to its tenants. Though this reorganisation of the Imperial Bank can be brought about, thus solving the vexed questions of securing the required constitution and the directorate¹ of the Central Bank, it is nothing but an inadequate appreciation of the results that makes possible this ill-considered agitation for reorganising the Imperial Bank. Even granted that all practical difficulties in reorganising the Imperial Bank are successfully solved and that the shareholders of the Imperial Bank agree to the limitation of dividend at 18 per cent. and remain contented with a subordinate rôle of acting as consultants in the management of the reorganised Bank and that the control and supervision of the Government is happily superimposed, it does not immediately follow that the new organisation would meet with success.

Without ample financial resources and without any public confidence the Imperial Bank exists at present unable to pursue any bold and energetic policy. So it is proposed to make it a dominating Central Bank by rectifying the major defects. Note-issue would be handed over after making due provision for its elasticity by the

¹ See the *Economic Journal* (London), September, 1928--an article on "the Indian Reserve Bank," p. 413.



employment of a graduated tax on deficient reserves. The note-issue would be based on the general commercial assets of the Bank rather than on its holding of government securities. The necessary staff should be lent to the Imperial Bank and it would facilitate matters and ensure good management of the note-issue from the beginning. Centralised control and protection of public interests would also be secured. Free transfer of funds in India would be allowed to other banks. No more branches would be established in future in such places where other banks or their branches exist. Even at the existing branches of the present time dealings would be confined solely to Banks and competition would be eschewed altogether. Rediscounting can be safely allowed by the Imperial Bank by virtue of its added strength, namely, the note-issue. With proper facilities for encashment of notes and a proper provision of sufficient reserve, namely, sufficient coin and bullion and other liquid assets to act as a secondary reserve, the reorganised Imperial Bank can provide the needed accommodation in our money market. Managed with economic foresight and a correct appreciation of the Indian situation the Imperial Bank of India can be made to play the rôle of a Central Bank or an apex bank assisting other banks.

There are certain disadvantages arising out of this scheme. As earnings must be large enough to maintain the present rate of dividend and maintain the prestige of the Imperial Bank in the eyes of the public a liberal use of its funds would be necessary. As one eminent banker says "earnings constitute the gauge of success applied by a large section of the public including many bankers. It is characteristically human to uphold the successful enterprise and to obstruct the unsuccessful. A small percentage of reserve coupled with unqualified approval will constitute more potent power of support than larger reserves with less of popular confidence."¹ In order to exercise powers of credit control the Imperial Bank must have some funds invested, the withdrawal or release of which would exercise a beneficial influence. It is not emergency relief alone but continuous operation on a scale to maintain the present rate of dividend would be essential. Even if this takes the shape of too frequent rediscounting

¹ See H. L. Reed, "The Development of the Federal Reserve Policy."

it might easily lead to an expansion of credit. Another danger would be that its funds would be used by the rediscounting banks and the ability to act promptly in times of disturbances would be checked. To cover even the bare operating expenses of the Imperial Bank with its present number of branches would require huge return and constant employment of funds either through rediscounting, and we have already seen the dangers of this step, or by its open market operations and direct relations with the trading public in which case the cry of "uneconomic competition" would be easily raised by the Indian joint-stock Banks. It cannot avoid in this case becoming a competitor with other banks and it is one of the established orthodox tenets that a Central Bank should not compete with its "constituent" or "member" banks.

The fusing of continuous commercial banking operations with that of the national duties of the Central Bank is theoretically impossible and practically dangerous to the existence of the Central Bank itself. At crucial times it would either have to sacrifice its commercial operations or forget the national responsibilities of maintaining a sound currency and credit mechanism for the country. It will not be "proof against the possibility that the discharge of its duties towards regulation of the currency may be affected by its interest as a trading organisation working for profit." An "impartial harmonisation" of the two diametrically opposite duties cannot be secured. Even supposing that both God and Mammon can be served equally faithfully there will be a strong reaction on the banking progress of the country by reconstructing the Imperial Bank as a Central Bank of Issue. The recent Royal Commission on Currency argues that the Imperial Bank should extend commercial banking facilities and so two banks are needed. The existing banks can be subsidised to undertake commercial banking under proper safeguards. Hence this argument cannot be considered as the sole or the most important one against the decommercialisation of the Imperial Bank.

The Future of the Imperial Bank.

Now that it has been shown that it is essential to create a new Central Bank of Issue, a change in the status and constitution of the Imperial Bank would be brought about as soon as the Imperial Bank

of Issue is created. As in Greece so also in this country there will be two banks in existence as a result of the reluctance and impossibility of decommercialising the premier bank and converting it into a Central Bank. Undoubtedly the same thing would happen in Australia where an attempt is being made to start a new Central Bank. The true line of reform would be not to decommercialise the Commonwealth Bank of Australia but start a new institution.

The work of pioneering banking business up and down the country is the special task to which sole attention should be paid. As it has conducted this business satisfactorily it should continue to act as the "spearhead" of banking development in the country. Acting as the exclusive bankers of the Government the Imperial Bank obtained an 'exceptional catchet' in this line of business and did invaluable service in extending branches in the interior. This pioneer work must be continued as the task of 'piping' the country together has not been completed. A free use of Government balances might be given if this useful service of developing the internal credit resources is not to be given up. Money may be deposited at low rates of interest or free balances may be given or payments may be made for services rendered. The mere provision of rediscounting by the Central Bank would not be sufficient. A like concession would have to be extended to other strong banks possessing good record and sound reputation which are willing to render similar service in this direction. It is to the advantage of all that this task has to be performed on the most unimpeachable lines.

Provision of Machinery of Foreign Banking.

Reduced to the status of a commercial bank there would be no reason why it should not be freed from all the present restrictions. As dealings in foreign exchange have lost their purely speculative character since the days of stabilisation of exchange it would be an easy task for it to conduct exchange business. Exchange risk can after all be avoided by the simple expedient of covering every spot or forward exchange contract by a compensating spot or forward sale or purchase. But an excessive locking up of funds either in British or Sterling securities or Indian securities would restrict their easy availability in case of emergency in India. Although at such times it can

count on the rediscounting of bills of exchange at the Central Bank its primary purpose of helping trade and commerce would be defeated by this unduly large holding of Government securities.

It should also be freed of the restriction to borrow in London on its assets. This would give the needed elasticity to its funds. It should also be allowed to receive freely deposits outside India and thus extend its business in London as well as in Ceylon. A removal of these restrictions would increase the driving force of the Imperial Bank in the banking system of the country. Should it be directed towards branch extension in this country or depriving the Anglo-Eastern Banks of the monopoly of financing India's foreign trade? Either way it would be conferring distinct benefit to the Indian money market. But the greatest necessity of India is to have a big commercial Bank extending sound banking facilities in the mofussil and, so long as this involves locking up advances or getting overlent to the danger of its liquidity, too much concentration on exchange operations should not however be insisted upon. With greater number of branches than at present in the interior it should come into closer contact with the co-operative banks and it should be its systematic policy to develop co-operative banking amongst the agriculturists. There is a considerable leeway to make up. The good work already accomplished in this field must be pushed forward more vigorously, wholeheartedly and systematically.

Renewing the Contract.

Apart from the indirect advantages it secures from the prestige of being the Government banker, the Imperial Bank of India has the free use of Government balances. The consensus of opinion is that a sufficient *quid pro quo* is not exacted from the Imperial Bank in return for the direct and indirect advantages that it has been able to derive from the Government account. The mere extension of a hundred branches is not considered as a sufficient return for the Government money. The popular cry is that something more tangible should be ceded by the Imperial Bank for the exclusive monopoly it enjoys in handling the reserve treasuries. Some opine that the system of training apprentices, which has been done in a number of cases, is far from satisfactory. While a thorough knowledge of practical work is gained

by the apprentices, most of them receive little further theoretical education and their knowledge of international banking conditions is next to nothing. They tend to become mere matter-of-fact bankers with no large outlook, or experience of international banking and business, or big imagination. There is no effective tackling of the statistical data of their business and no conclusions of their experience are placed before the general public. In the absence of such reliable data it is difficult to reach any conclusion as regards the distribution of credit or its adequacy with reference to the needs of the community. The average value of the bank advances and accounts are not given out by the Managing Governors in any of their speeches. Is the range of lending wide? Are there any ill-balanced and over-weighted large advances to select groups of particular borrowers? Is there any great disparity between the greatest and the smallest of the advances? Is the practice of indirectly aiding the Native shroffs in the expectation that it would trickle through their channels to the agriculturist satisfactory? Does it amount to enough support at reasonable rates to the dominant industry of our country, viz., agriculture? Where are all the bank advances going? Really speaking these questions are of great importance. These questions and similar other queries can be easily posed but so long as the practical bankers are unable to answer them nothing can be done as regards the application of the sound canons of banking, viz., safety, adequacy, economy and efficiency. As most of the trained apprentices do not come up to the required level the problem of training Indian bank personnel remains unsolved.

The general public requires something more spectacular to result out of the inter-connection between the Imperial Bank and the Government of India. There are others who wish to impose more drastic conditions at the time of the renewal of the contract which takes place in 1931. In the absence of a Central Banker the Imperial Bank or some other banker would undoubtedly have to be selected as the Government Banker and what guarantee is there that King Stork would be a better substitute than King Log. A multiplicity of government bankers is something contrary to existing practice prevailing in the world. It again would defeat the main object of creating a Central Bank which is nearly the creating of a big monetary pool to be utilised effectively in the wider interests of the country. Hence

it follows that the Imperial Bank would have to be selected for a further period in the absence of a Central Bank. As it is not to the best interests of the country that it should be postponed something like real rapprochement can be arrived at and a Central Bank of Issue started by the year 1931. In the event of a Central Bank of Issue coming to existence at that time a re-examination of some of the important recommendations of the Hilton-Young Commission in the matter of the Central Bank's work is essential. It is suggested that the Imperial Bank is to act as the sole agent of the Reserve Bank or Central Bank of Issue. It would lead to the setting up of the cry of favouritism. The Imperial Bank should not be the only "Pet bank" but in the interests of banking progress it is essential to appoint other sound banks for its agency work. Till recently the Federal Government of the U.S.A. placed its balances in some of the National Banks. It is indeed true that this system had its own defects but in the peculiar circumstances of our country it is hard to expect the general public to repose trust in such banks which are not selected as depositaries of public money.

Likewise there should be no restriction on local governing bodies to place their deposits in any bank they may choose. Already some of the District and Local Boards are depositing their balances in the Co-operative Central Banks existing in their centres. The prevailing practice in the Scottish banking system favours this idea. There is keen competition on the part of the existing English Joint-Stock Banks to secure the accounts of municipal bodies and other quasi-Governmental organisations.

Equally efficient service can be rendered by the other joint-stock banks in the matter of the agency work of the Treasury. The practice of appointing different banks as agents of the Treasury was once contemplated in this country. It was suggested in 1861 that the Bank of Agra was to be given the Treasury work at Agra and Lucknow while the Presidency Bank of Bengal was to be given the Treasury work of Allahabad, Delhi, Lahore, Jubbalpore, and Nagpore. This was to a certain extent responsible for the branch expansion policy of the Presidency Banks. Even though it can be retorted that those were the days when the art of modern banking was not perfected and so no conclusion can be drawn, a recent monthly circular of the Barclay's Bank has raised a similar issue and has been questioning the

monopoly of Government banking business in the hands of the Central Bank.

So the suggestion of appointing other banks as agents of the Central Bank deserves responsible examination. The main advantage of such a step is to give the selected banks good prospects of future development and it assures them of a settled position. The attendant disadvantage of government funds being lent at different rates by competing banks would ensue and if there are too many depositaries it is likely to react adversely on the standard of banking. The advantages promise to outweigh the possible disadvantages and for a few years this practice has to be carried out under proper safeguards.

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CHAPTER III

A CENTRAL BANK OF ISSUE.

The necessity for a Central Bank—The example of other countries—Impossibility of decommercialising the Imperial Bank—The organisation of the Central Bank of Issue—The working model of the Bank—The work of the Central Bank—The practical difficulties in the path of the new Central Bank of Issue—The future of the Central Bank of Issue.

A Central Bank of Issue.

The history of Indian Banking from the year 1836 has been that of a long unsuccessful struggle for an efficient Central Bank. When during the last year, Sir Basil Blackett took up earnestly the task of adapting the recommendations of the Currency Commission to the needs and exigencies of the situation in India, it seemed as though we were nearer the goal than in the last century or at any subsequent period. Our hopes were not only sustained but also strengthened by the eagerness of the Finance Member to reconcile the conflicting viewpoints of the India Office at Home and the Assembly in India. Yet it was this very eagerness that landed the bill in new and unexpected difficulties. The hourly changes both in the framework and in the details of the two Reserve Bank bills soon roused the fears of all enthusiasts for the Reserve Bank that it would ultimately end in a deplorable fiasco. When Sir Basil's anxiety to placate Indian political groups led him into one deadlock after another, the opponents of the Reserve Bank took advantage of the tangle to press their view that 'India could wait for her Central Bank.' It is noteworthy that such opponents of the Reserve Bank comprise not only the European banking interests but also certain groups of Indian businessmen and politicians of which Sir Purushottamdas Thakurdas and Pundit Malavya are the most prominent. The former has always preferred to solve the question of the Central Bank by a postponement *sine die*.

It is common knowledge that the European interests have always preferred this solution. Presiding over the Annual General Meeting of the National Bank of India, held on April 3, 1928, Sir Charles MacLeod remarked, "the necessity for a Reserve Bank in India may arise in time but in the present state of banking development in the country my colleagues and I do not think that the time has yet arrived or that some delay in its establishment can do any harm. If, however, in course of time it should be found to be essential that such a bank should be established *we consider it of the utmost importance that it should be a shareholder's bank and free from all possibility of political influence.*"¹

The Indian opponents have not also changed their opinion to the required degree and it may, therefore, be considered imprudent to press forward with any scheme of Central Bank at the present moment. The Government could by assuming a stiffer attitude, have brought out a Reserve Bank in a more or less acceptable form. But confidence is the keystone of any banking structure and so long as there is no guarantee of ready support from all quarters, it is not only wise, but imperative that its consideration should be postponed to more propitious circumstances. A peculiarly opportune time would arrive by reason of the necessary revision of the Imperial Bank's Charter and the following considerations on which a Central Bank should be founded and should conduct its operations, would be of immense service to the public.*

The Example of Other Countries.

It is worth while to consider the decentralised banking system which presumably is the ideal in the minds of the critics of the Reserve Bank. Canada is not much the worse for the want of a Central Bank and the thorough organisation of a money market. It is also true that the Irish Free State Banking Commission, presided over by H. P. Willis, recommended the adoption of the system of banking obtaining in Canada.² But for India—it is clearly unwise to consider

¹ Italics mine.

² See the Interim Report of the Irish Banking Commission of 1926—quoted by the London Bankers' Magazine.

these examples as worthy of imitation. Conditions here are radically different. The Ministry of Finance in Canada, in the first place, commands the full confidence of the public and the business circles. The Canadian Banks have developed an extensive system of branch banking and enjoy an invaluable aid in their ready access to the money market of New York. But in India the Finance Department is suspect beyond words. The indigenous banking system is still in its infancy and branch development is unknown except in so far as it has been attempted by the Imperial Bank. That the banking system of Ireland and Canada is still far from being a finished model completes the case against India trying to move on similar lines.

We have therefore no alternative but again to put our hands to the formation of a Central Bank, the constitution and management of which will be suited to our own peculiar requirements. It is fortunate that, in spite of the highly disheartening fate of the last attempt, our academicians are alive to the rich harvest of benefits which a Central Bank of Issue can confer on the industrial and economic well-being of the country.

These supporters of the Central Bank scheme consider that no time should be lost in starting a Central Bank as the pivot of the Indian money market satisfactorily adjusting credit and currency and bringing about an adjustment of the volume of credit to the volume of business needs of the country.

A Central Bank of Issue is necessary for the development of the banking resources of the country. It would furnish the means by which banks in need of larger reserves can borrow from the Central Bank and thus a national control over a sound and elastic credit and currency system can be secured through the Central Bank of Issue which is wholly free from the influence of either domestic political pressure or powerful external factors interested in exploiting our resources to their permanent benefit.

With its monopoly of note issue it can act as the channel for the output and intake of legal-tender currency. It would circulate a new kind of paper money which would soon constitute the bulk of legal-tender money in circulation. The Government can be divested of the control over currency which can be entrusted to this banking machinery.

Holding the Government treasury balances, currency reserves, and the reserves of other banks deposited statutorily in its hands, it can pool together all the cash resources which now lie scattered far and wide. It can act as the agent through which the financial operations of the Government at home and abroad can be transacted.

As the sole and ultimate provider of the emergency currency which can be obtained by rediscounting approved bills or granting advances on approved promissory notes of the commercial banks, it can bring about the expansion and contraction of currency required to maintain stable monetary conditions. It would relieve the temporary pressure to which the small banks are generally liable and arrest the failure of those sound banking establishments which unfortunately fail to draw the difference between *immediate* and *ultimate* convertibility and commit the mistake of locking-up funds in 'slow assets.' Currency famines would be prevented. Bank runs will not be the epidemic that they are. By its direction and regulation of the money market the Central Bank can renovate thoroughly the entire banking structure of the community. Under its supervisory influence the country's finances can develop freely without any hindrance from communal or party feelings, personal differences and political animosities. Its self-denying ordinance in the matter of dividends, its insistence on a high standard of banking, its efficient management of currency, and its detached eminence from the ordinary commercial banks of the country, would enable it to regulate our national monetary and financial matters in the real interests of the country. Desirable changes in bank reserves, currency, cheque collections, Government finance, credit policy, gold movements and the money market can be secured only through the instrumentality of a Central Bank of Issue.

The starting of a Central Bank would soon enable the country to realise that the bank rate and a wise discount policy can shower such inestimable advantages as credit expansion, suitable both in point of time and degree, stable foreign exchanges, regulation of gold movements and maintenance of price-levels at a reasonable stability.

The inequality of interest rates in different parts of the country can be removed by loans made to each other by the branches of the Central Bank at the direction of the parent bank. An equable flow of funds from one part of the country to another and from one

industry to another, can be secured. It can act as the custodian of the national reserve with no selfish ends to pursue and administer the reserves in the public interest. Another advantage would be the disappearance of quotations of inland exchange rates, and the premium on Bombay or Calcutta or Rangoon funds would disappear as soon as an efficient wire-transfer system as in the case of the Federal Reserve System is adopted in this country. Under the leadership of the Central Bank, a banking policy would become possible. Free from all suspicions as the proverbial Cæsar's wife was, or ought to have been, it can introduce an exceptionally high degree of integrity into the financial life of the country and secure its real financial independence, sounder economic organisation and practice. When such are the manifold advantages which can be conferred by the Central Bank of Issue it is sad to think that the Reserve Bank proposal, which ought to have been welcomed as it aimed to create the Central Bank, was turned down after being accorded every kind of maltreatment. It was subjected to the full blaze of hostile and unfair criticism both in the press and on the platform and scorched and burnt out of recognition before it was finally put aside. The worst result of this unfortunate episode is that the public has been blind-folded and so whirled round as in a blindman's buff that it is perfectly dazed in regard to this question. Changing the metaphor one may say, it has lost all its bearings and its path lies through uncharted seas of rival schemes, of constitution and management, through rocks and shoals of communal antipathies and political intrigues.

Can the Imperial Bank "be raised to the sky" ?

The impossibility of decommercialising the Imperial Bank with a view to make it the Central Bank of Issue has been ably expounded by the Hilton-Young Commission itself.² The report has explained how

¹ What the F. R. cheque collection system does for the cheques, so also, similar service is extended by wire transfers and telegraphic settlements. The Gold Settlement Fund in Washington enables this service to be done effectively without any physical shipment or movement of funds from one part of the country to another.

² See paras. 83 and 85, Final Report. See also Sir Basil Blackett's Speech at Delhi University, Nov. 1926.

a host of practically insuperable difficulties will have to be overcome in the process of transforming the Imperial Bank into a Central Bank. In the first place, it is unwise to entrust the duties of impartial credit control to the Imperial Bank which is predominantly non-Indian in its directorate and management and which has inherited all the narrow traditions of the Presidency Banks. Even if these evils are obviated, it is not easy to compensate the present shareholders of the Imperial Bank for the reduction of the opportunities of making profits which the control and regulation of the money market solely with an eye to the national interests of the country would inevitably involve. This has been made a problem by itself even in the event of our deciding to establish an altogether new institution as a Central Bank.

The Imperial Bank would undoubtedly press forward its claims to compensation on the failure to renew the present agreement as regards Government business. Publicists have already shown the retrograde character of the Hilton-Young Commission's recommendations in this direction.¹ At the end of the period of the present agreement the Government has the choice to renew it or to withdraw from such a contract—a provision made for the contingency of having to establish a Central Bank of Issue.² It has not been sufficiently stressed that the removal of all the present restrictions in the matter of its operations is itself a sufficient compensation for the loss of the Government business and that with some amount of real push it can make good the loss arising from this direction. Preferential treatment at the hands of the new Central Bank would be an impossible thing and even the continuance of the present contract after the expiry of the period in 1931 would be doubtful. A real attempt

¹ The Commissioners were freely carried away by the example of Greece. The National Bank of Greece was given the privilege to contribute towards the shares of the Bank of Greece, the Central Bank that has been recently created.

² "The Imperial Bank will have no legal claim for any Government benefits and also no moral benefit rights."—Quoted from a letter of the Managing Governor of the Imperial Bank to Rai Pramathanath Mullick, Bahadur—June 28, 1927. Since these lines were written the President of the Bombay Board, Mr. E. V. Branbury, admits that "the contract may be terminated after the expiry of the period by certain notice to be served by either party." So it is clear that no compensation need be paid to the Imperial Bank.—See the Statesman, 21st August 1928.

should be made at this opportune moment to found a Central Bank of Issue and as there would be no moral binding on the part of the Government to continue the contract, the unsettled question of compensation need hardly arise. With a free hand the new Central Bank of Issue can be created according to the cherished desires of the people and the London money market interests who also stand to gain by this new organisation. Even if the Central Bank cannot be started in 1931, the Government can continue the present terms for a limited period and it need not feel any compunction in overhauling these terms when the Central Bank is to be newly established. In order to minimise the disadvantages attendant on a sudden removal of Treasury balances from the Imperial Bank, gradual transference of the same to the Central Bank can be arranged.

The Organisation of the Central Bank.

Analysing the constitution of the important Central Banks of the world we find them to fall into three different classes. They are either (a) pure shareholder's banks, (b) pure State-owned banks, (c) banks of mixed ownership. But in the last category there are several sub-divisions. (1) Where the State and the shareholders own the capital of the bank. (2) Where the State, the indigenous commercial banks, the foreign banks and the private individuals have the privilege to own the shares of the Central Bank. (3) Where the capital is or can be owned by the State, the shareholders and the indigenous banks. (4) Where the capital is owned by international groups and State donation.—All these can be considered as quasi-state banks. But there is another type which belongs to this classification of mixed ownership. All Central Banks, which have their capital subscribed by the shareholders and the indigenous banks of the country alone—and the State is no shareholder—must be considered as banks of mixed ownership. Which of the above types can India select?

Pure shareholder's Central Bank.	Pure State-owned Central Bank.	Mixed ownership.
		(a)
The Austrian National Bank.	The Commonwealth Bank of Australia.	The National Bank of Czecho- slovakia.
The National Bank of Bel- gium.	The National Bank of Bulgaria.	The National Bank of Copenhagen.
The Bank of England.	The Bank of Estonia. ²	The Bank of Mexico.
		(b)
The Bank of France.	The Bank of Finland.	The Central Bank of Chile.
The Reichsbank of Germany.	The Bank of Latvia.	The Bank of the Republic of Columbia.
The National Bank of Hun- gary.	The Bank of Poland. ³	The Bank of Lithuania. ⁴
		(c)
The Bank of Italy.	The State Bank of the R.S.F.S.R.	The Federal Reserve Banks of the U.S.A. ⁵
The Bank of Japan. ¹	The Swedish Riksbank.	The Swiss National Bank.
The Netherlands Bank.		The Bank of Greece. ⁶
The Norges Bank.		(d)
The Bank of Spain.		The South African Reserve Bank. ⁷
		(e)
		The Bank of Albania.

¹ The State can own half of the capital of the bank.

² From 1929 the Government would endeavour to sell the shares to the public.

³ Shares worth 50 million zloty, first subscribed by the State, can later on be sold by it to the public.

⁴ The chief peculiarity is that Municipalities, Companies and Associations other than individuals can also become its shareholders.

⁵ There has been no offer of stock to the public or the State as contemplated by the statute for this has not been done up till the present. *In reality* they are shareholders' banks but member banks alone can become shareholders.

⁶ The State has no share in the capital of the bank. See Kisch, "Central Banks" also "Memorandum on Central Banks" issued by the League of Nations. See also Spalding, Dictionary of World's Currencies.

⁷ The State can hold shares worth $\frac{1}{5}$ of the total capital amounting to 400 mil. drachmas. It is the intention to ultimately unload this share capital on the market and make it a pure shareholders' institution. See the London Economist, p. 608 (1926).



While there is a large measure of agreement on the necessity of starting this new banking structure there is, however, considerable difference of opinion as regards its constitution and management. One school regards the State-aided shareholders' Bank as the best ideal. A privately-owned Central Bank managed by competent businessmen free from political pressure and Governmental control is certainly best fitted to control credit and currency in accordance with the needs and necessities of business. It is only a shareholders' bank that can hope to obtain emancipation from political pressure and secure independence from the interference of the Government executive in the day-to-day control of its business regarding its banking policy. Examples of other countries where shareholders' Banks have worked successfully can be cited with confidence. It can also be emphasised that the State has earned a notoriety as a bad manufacturer, an indifferent financier and an indifferent merchant and would doubtless prove an incompetent banker. The State is too wooden and soulless to succeed in gauging accurately the monetary requirements of the business people. Hence the shareholders' bank which is governed by motives of self-interest would be efficiently and properly worked for the commercial interests. The knowledge and capacity of practical businessmen are sure to keep them to the right path. Banking is a species of trade in which the Government should not take part; for, if it does, it would lead to an irresistible demand for a too liberal extension of discounts and loans during days of depression and inflation would easily become the watch-word of every demagogue.

It must however be recognised that all the arguments are not in favour of the shareholders' bank. Firstly, anybody can become a shareholder and deal with technical matters such as credit and currency which can be handled by experienced men possessing talent, study, skill and experience. We cannot expect any large number of shareholders to give "a single thought to the object for which the Central Bank is supposed to exist." The shareholders' control over the directors is generally a myth, and always ineffective; and so long as the usual dividends are forthcoming it is impossible to rouse any serious interest in internal affairs. A private shareholders' bank necessarily means hunting for profits and if the Central Bank of

Issue is to perform its real duties, hankering after profits would defeat the wishes of the enthusiasts who aspire to make the Central Bank of Issue the controller of the credit and currency mechanism of the country. This was the case with the South African Reserve Bank which had to perform additional functions in order to pay a dividend to the shareholders and cover a portion of the overhead charges. It was on this very ground that the recent Banking Commission of the Irish Free State also disapproved of the idea of the private shareholders' bank. But some amount of conscious control can be devised to make the shareholders' bank alive to the national economic interests. All the privately-owned Central Banks of Issue, with the notable exception of the Bank of England and the reorganised Reichsbank of Germany, work more or less under a rigid system of control or supervision so that national interests in financial policy can be secured easily. In countries where established banking traditions exist and where trained bankers are available to run the Central Bank on sound and conservative lines, the control of the State would naturally be relaxed.

In case of the poor countries, however, it may be considered uneconomical and unwise to pay a high rate of dividend derivable from the use of the currency reserves to the private shareholders of the Central Bank, while capital can easily be borrowed for the State Bank at four or five per cent. But it must be borne in mind that just as the State ought to concern itself with adequate service and not the question of profit from its police department, so also it ought to concern itself only with efficient and economical administration of banking operation in conformity with approved monetary theory. The possibility of making profits from the handling of the note issue should not therefore be allowed to rule out on that account the desirability of the shareholders' bank. Arrangements can be made for the participation of the State in the profits but it is not prudent to start banking operations with any obsession of profiteering.

The next consideration is that in countries where indigenous capital is not sufficiently developed the starting of a shareholders' private bank would inevitably lead to a bid for ascendancy in the practical management of the banking and the financial system of the country between the foreign and the indigenous capitalists. It is always

essential to eliminate foreign influence from the control of the Central Bank of Issue. It is also true that a privately-owned shareholders' bank generally fails to be sufficiently representative of the different interests in the country. But these are by no means conclusive arguments in favour of the state-ownership of the Central Bank as practical provision for Government interference can go a long way towards mitigating the evil effects of private ownership. The composition of the Central Bank's direction can be so arranged as to eliminate the influence of the foreign capitalist. The reservation of the powers of nomination to the Board of the Central Bank would rectify the second evil so that by means of nomination by the State men of wide experience representing the important economic interests can be placed on the Board.

Though the disadvantages attendant on the shareholders' bank can be toned down by devising suitable remedial measures, such as the limitation of dividends to shareholders, the allotment of shares to small investors scattered all over the country, the restriction of the voting power to "one man one vote," the prevention of the right to vote by proxy, the prevention of manipulation of votes by big shareholders, the creating of non-transferable shares to prevent concentration of control, the appointment by Government of outside business experts to manage the institution, the making of the shareholders' body a purely consultative one, the proper defining and limitation of the functions of the open market operations of the Central Bank, effective publicity of the operations of the Central Bank and the participation of the State in profits beyond a certain level which are some of the methods usually followed, yet there are however some practical contingencies under which the privately-owned Central Bank can lose its independence and its devotion to the public weal.¹ The fact is that too much value should not be attached to the mere theoretical independence of the shareholders' bank. For much, too much, depends on the unwritten traditions and conventions of the institu-

¹ Mr. Keynes says, "Even in the case of the Bank of England the Government of the day would generally have the last word in the end and although formally it is a private company with the greater measure of independence informally there is always a sort of persuasion and a spirit of trying to see each other's point of view." Qns. 13056 to 13059, Hilton-Young Commission, Evidence taken in London.

tions and the exigencies of the financial situation in the State. Even a privately-owned Central Bank can be used as an engine of State policy. In times of pressure such as there were during the last war, private shareholders' banks have become purely Government bankers and have relegated their chief duties of bankers' bank to a secondary position. These Banks of Issue would be made to discount Treasury bills or grant advances to the State on interest-bearing State bonds. They can assist the Government indirectly by granting loans and advances at favourable rates to commercial banks on security of Government paper in various forms. Lending indirectly to banks to help the Government would make the credit of the Central Bank semi-automatically liquid. As banks secure surplus funds, they would liquidate their indebtedness to the Central Bank while this desirable result would not be forthcoming if the Central Bank itself were to lend directly to the Government.

Even if the legal status of the Central Banks be so secured as to make it independent of Government control, it would have little effect upon the actual relations with the Government. Political influences cannot but tell ultimately on the privately-owned Central Banks. The divorce of business from politics cannot be pushed too far. The administration and policy of the Central Bank, though conducted on the most scientific lines, may sometimes have to be persuaded to see the Government's point of view.¹ Even the Bank of England is often subject to such pressure. But under normal circumstances lending by a private bank is far better as it would take the matter out of politics.

Again it is difficult to reconcile the idea of a privately-owned bank with the state guarantee for the bank-notes. This is the anomalous situation which the shareholders' plan of the Reserve Bank would have created and it is meaningless that the Government should

¹ See H. P. Willis, "The Banker," October, 1927. Under political influence it seems that since 1921 up to the present time the Reserve System and the F. R. Board in particular has been under severest pressure to adjust interest rates so that the main objects of the F. R. system during the years in question has been the establishment of easy conditions for public financing, rather than the restoration of sound liquid conditions in banking." See also Dr. T. E. Gregory, "The Federal Reserve System of the U. S. A." with an introduction by Walter Leaf.

give their guarantee without gaining an effective voice in the management of the bank. Perhaps a quasi-state partnership would be inevitable under such circumstances. However safeguarded the privileges may be according to the terms of the original charter, concentration of shareholdings would soon be the prevailing feature and unless some sort of racial discrimination is made in the legislation, it would not be possible to prevent aliens from becoming shareholders to a greater degree than can be considered safe. But where for any reason racial discrimination is not possible, the shareholders' bank must be considered more or less wholly unsuitable.

State-owned Bank.

Ever since Keynes wrote his classic report in 1913, Indian opinion has been overwhelmingly in favour of the State-owned Central Bank of Issue which should on no score be mistaken for a State-controlled Bank. There is a prevailing opinion among people that the special circumstances of India warrant the creation of a State Bank. The co-operative credit movement in India succeeded because of the State aid rendered effectively and if it had been left purely to unorganised self-help nothing so miraculous could have been achieved. In all matters of high finance the Indian people look to the Government to sponsor any new movement and the Government is always considered as the most potent factor in finance. In any sphere it would be difficult to divorce a system from the habits, customs and desires of the people who make use of it. Very great weight attaches to a Bank founded upon the credit of the Government and its resources. It would go a long way in implanting the banking habit in the minds of the people. Several people quote the instances of the state-owned and state-controlled Central Banks which existed in Australia, Bulgaria, Czecho-Slovakia, Esthonia, Finland, Hungary, Japan, Latvia, Poland, Russia, Sweden and Uruguay and argue that the State Bank can be started on suitable lines in this country. Even Recardo advocated the creation of a State Bank in 1817 on the model of the Swedish Riksbank. He advocated a State Bank for England on the model of the Riksbank *totally independent of the ministers.* He says, "the sinking fund is managed by Commissioners responsible only to

Parliament and the investment of the money entrusted to their charge proceeds with utmost regularity. What reason can there be to doubt that the issues of paper money might be regulated under similar arrangement." Except this positive pronouncement in favour of the State Bank, no other arguments are given by him.

It is argued that the State Bank would give the quietus to the endless quarrels on the part of the Imperial Bank, the Exchange Banks, and the indigenous banks for having the greater share in the capital of the Bank. The characteristic fear of control by foreign capitalists would also be avoided by starting a State Bank without a substantial share capital. Such a bank would be sufficient for the present situation in India as there is no properly developed bill market for the present. A State Bank would draw the infructuous capital out of the pockets of the people in the shape of deposits. Even the quasi-State Bank would do something in this direction and capital may be invested in the shares of the Bank.¹

One of the strongest points in the armoury of the supporters of the State Bank scheme is that the Government of India generally keeps on an average about Rs. 5 to 19 crores of loose balances every month in the hands of the Imperial Bank and that the Government are sustaining a dead loss on account of this arrangement. The State can act as a Central Banker without any undue risk and with the unlimited means at its disposal earn sufficient resources to liquidate a portion of its debts or reduce taxation to the relief of trade and enterprise. The issue of money is a function of the Government and it ought not to be surrendered to any body of individuals however well-informed and disinterested they might be.

Besides the above positive arguments some of the following negative arguments favour the conception of the State Bank ideal. A private Central Bank can easily become an annexe to the British commercial community which largely controls the

¹ See the London Times (March 13)—Article on the State Bank for India—"There can be no question that a State Bank would have a most salutary effect in securing the confidence of the people with money to invest. India suffers from a vast amount of infructuous capital which a State Bank would be likely to draw forth in the shape of shares or deposits. Hitherto the investment of money by deposit in banks has been on a much smaller scale than it ought to be."

Indian banking of the present day. The directors of a private bank would be responsible to nobody while a sort of parliamentary control, though it might prove to be a disadvantage at certain times, can be exercised over a State-owned Bank. London high finance or the British commercial community has no confidence that the Indian Legislature would not select either public officials or persons identified with political groups or banks, but would select only men of the highest standing engaged in active business in India. If this thing is statutorily secured, the problem of control over State Bank would be solved. The main reason why the Indian people are so strong and persistent on giving to the Legislature the control of the Bank is this. The Indian Executive is an *imperium in imperio*. It has full control over its loan policy and floats the loans at such rates and in such markets as it chooses. The Indian Legislature has no control over this policy. People who are already aware of this limitation are keen on securing the control over the Central Bank. If the executive is to be held responsible to the legislature, this insistence would neither be necessary nor demanded. Rightly or wrongly, they have considered the management of the Central Bank a political issue. Although the underlying motives which ought to guide the framers of the banking structure should be based on economic considerations, it has unavoidably taken on a political colour.

The Demerits of the State Bank.

A State-owned bank under State control is not, however, free from defects. When it is controlled by the State, it tends to become a mere banking department of the Government. The situation would be something analogous to a State Railway system or a State industrial monopoly. The pressure of political expediency may often prove irresistible and such business propositions as will not be undertaken by any ordinary bank would sometimes have to be entertained for more or less purely political reasons. The history of the Swedish State Bank (Riksbank) during the first part, say 1668-1834, illustrates how the bank became an element of intense political strife of the day. During the second period of its history (1834-1926) it succeeded admirably as a Central Bank and was kept independent

of the Government of the day and at the same time without being under the control of private interests. This was due to three conventions adopted by the people. (1) The Bank Commissioners were traditionally re-elected until they wished to withdraw, thus securing continuity of policy. (2) They maintained a certain proportion between the "technical" and the "political" Commissioners. (3) They preserved the institutional conservatism of the State Bank. Such measures can be adopted by this country if the State Bank conception alone is approved. In the case of the poor countries like India which are not economically developed but politically subject to foreigners the advantages flowing out of a State Bank may well be expected to outweigh the evils thereof. With a different constitution, measures which are not to the interests of the financial creditors and political masters would ordinarily be neglected. It is for this reason that the State of Czechoslovakia has contributed to the share capital of the Anglo-International Bank formed in 1927. This Bank is specially meant to finance the international trade of the country and further trade relations between Czechoslovakia and the United Kingdom. But in a State Bank we have to reckon with the danger of socialist aims and programmes creeping slowly into the sphere of national banking.

A State Bank can also be used for inflationary purposes by needy financiers who may be hard put to balance the budget. They can make encroachments on the State Bank's funds. The history of the Bank of Amsterdam which was organised as a State Bank is an illuminating instance in point.¹ It was illegally mismanaged by a committee of the Town Council ; money was lent for political purposes, some of it for municipal money-lending schemes designed to help unemployment caused by the war and some to the Dutch East India Company which carried great political influence. The bank, as need not be added, had to wind up its affairs at the end of the war. Again it is also quite possible that public bodies might not be getting as much credit at the hands of the State Bank, as they would at the hands of the ordinary bank. There is keen competition in England among banks for securing the accounts of the quasi-Government bodies and if banking is nationalised they fear that they would receive less

¹ See Walter Leaf, "Banking," p. 184.



favoured treatment. It must also be realised that many experiments in the direction of State Banks have met with failure and the oft quoted illustrations are the failures of the State Banks of Russia, Bulgaria, and the first and second Banks of the United States of America. There are some who quote exultingly the example of the Dominion State Bank of the Australian Commonwealth which started without any basic capital of its own.¹ A mass of data overwhelmingly adverse to State ownership of banking can be assembled.

It was only in July, 1927, that the Australian Commonwealth Bank began issuing weekly returns on the model of those of the Bank of England. Sir E. Harvey has not yet completed the task of approximating the Commonwealth Bank to the Central Banking type. It is now trying to open a branch in New York and this undertaking of foreign banking is not quite in keeping with the accepted practice of the Central Reserve Banking institutions.² Efforts are now being made to bring it into a close contact with the commercial banks and to bring it into line with the practice prevailing in other countries possessing a Central Bank of Issue.³ Their conditions are so different from ours that no parallel can be drawn with any justification.

The opinion of several competent economists goes to show that the State Banks lead to the "confusion between public credit and private credit and unless a dominating personality or a superman like Vichenagradsky or Count Witte commanding prestige in the world of finance as well as the State" runs the State Bank, it is apt to be ship-wrecked in times of bad weather.⁴

Another disadvantage of the State Bank is that it generally fails to weed out the weak and inefficient banks by refusing to rediscount their worthless paper. As a result of this spoon-feeding and nursing of the incompetent banks it fails to develop a ring of well-managed commercial banks acting in co-operation with it.

It is also stated that it may fail to train an adequate number of men who can be depended upon to run the banking institutions of the country in the future. This seems to be altogether an undeserving

¹ Mr. B. T. Thakur evidently confuses this fact for the Board of Directors and says that it has no Board of Directorate.—See *Organisation of Banking in India*, p. 105.

² See the *London Banker's Magazine*, Sept. 1927.

³ See the *London Times*—Article on Empire Banking, August 12, 1928, p. 135.

⁴ See Sir J. C. Coyajee, "The Reserve Bank of India."

attack and if a bank working towards public welfare and not private gain can do nothing in this direction it is impossible to believe that it can be performed by any other banking institution of the country.

The science of economics, however, has sufficiently advanced to enable us to establish a State Bank but yet secure it from its attendant disadvantages. Freedom from political influences may be guaranteed. A proper definition of its functions would safeguard it from experiments of socialism. The credit relations between the State Bank and the Government or between the State Bank and the other banking institutions can be placed on a statutory basis. An adherence to well-laid rules, *both in letter as well as in spirit*, would delimit its scope of interference with the working of the mechanism. By the compulsory training of apprentices and the promotion of banking knowledge and by founding an Institute of Bankers under its auspices, the State Bank can do something in the direction of training people in banking practice. But the most serious objection to State Bank remains unanswered. The State always protects itself against maturing liabilities by making even its future obligations payable on a fixed date or after, at its own pleasure. If in addition to this huge indebtedness, it undertakes *large demand* liabilities on note issues and *enormous demand* liabilities on bank reserve and other deposits that may be attracted, it would be a dangerous reversal of the existing policy outlined above. The responsibilities of the State would be very heavy and it is financial folly to saddle this Government credit with a heavy load. *True financial wisdom consists in protecting the credit of the Government against all possible danger.*

A Quasi-State Bank.

Students of Indian Banking history might easily suggest that it would be the happiest solution of the present situation if the Central Bank were to have a part of its capital, say two-thirds, owned by the shareholders and the rest by the State. Such a thing existed in the early years of the history of the Presidency Banks of Bengal, Bombay and Madras. The control may be exerted by mercantile directors elected by the shareholders and the Government directors nominated by it; two-thirds by the former and one-third by the latter. Government directors might have the right to veto the transactions considered

inimical to the Government's financial policy or public interests. This proposal cannot be rejected incontinently. It is not fraught with disadvantages greater than or greatly in excess of, the benefits derived. Great discriminations in selecting directors by the different interests would tend to inspire the people with confidence. The only grave defect of this scheme is that Government may fail to abstain from political interference or manipulation. Even a pure shareholders' bank is not exempt from such wilful, deliberate and inevitable interference on the part of the State. The main advantage of the quasi-State Bank is that it tends to make the Bank "the People's Bank" free from domination of sectional interests or London financial interests and the vagaries of the financial advisers of the Secretary of State. The representation of the State on the directorate of the quasi-State Bank can be so made as to secure a vigilant watch over the national interests and prevent the Bank executive from subordinating Indian interests to those of any other countries. These are the objects which any sound Central Bank, constituted on whatever basis it might be, has to secure and it is immaterial whether it is a State Bank or a shareholders' bank or a quasi-State Bank. Independently minded people who have the courage to veto measures detrimental to Indian interests must form the managing board and when this can be secured it is unwise to argue dogmatically or stand as sticklers for the principle of a State Bank or shareholders' bank or a quasi-State Bank.

Instead of recognising the merits and demerits of each of the plans and coming to a satisfactory compromise which can be made workable each party strove to have its own way till finally amidst the welter of this chaos, the stockholders' scheme which promised to contain the essence of the above proposals was evolved. The conception of the stockholders' Bank has to be thoroughly grasped before it can be realised how the best features of all the various schemes have been happily combined in the new proposal. A five per cent. India Bank stock is to be floated at par in Rs. 100 each or any multiples thereof but not exceeding Rs. 10,000. Thus in reality it is to be a State Bank. The whole of the 5 crores of authorised capital is not to be issued but one crore is to be issued later as occasion demands to render unnecessary for the trustees and directors to buy up the qualifying amount of stock in the market. Each province having 1,000 stockholders will maintain a register of individual stockholders

in the province and these have the right to elect one director who must hold at least Rs. 1,000 of stock. Sixty persons are to be elected as the trustees of the stockholders of the province and each trustee has to hold Rs. 1,000 nominal value of the stock. Every member of the Council of State, or the Legislative Assembly or the Legislative Council is to be an ex-officio trustee and it is these trustees that are to elect the directors. All the stockholders must be British subjects alone ordinarily resident in India. Besides the directors to be elected by the trustees of the shareholders of the different provinces thirteen others are to form the Board of Directors. One Governor and two Deputy Governors would be appointed by the Governor-General in Council. Two directors are to be elected from the Associated Chambers of Commerce. One director is to be elected by the Provincial Co-operative Banks. The Government can nominate four directors for three years in the first instance and thereafter for five years which is to be the period of tenure for the rest of the directors also.

It is not only true that many of the objections to the shareholders' bank or State Bank can be successfully overcome in this scheme but some of the following clear merits of the scheme can be successfully copied by the other countries which wish to construct a Central Bank of Issue. The regional basis of the directorate, the Indian predominance in the electoral college and consequently in the directorate, the limitation of votes and protection of small shareholders, are some of the salient points of an essentially sound scheme which any central banking structure can be proud of. It has also the merit of allowing the legislators a chance to be elected to the directorate. This feature is undoubtedly a concession to the Indian public opinion and would not make the Central Bank "a purely political bank" as the members of the Legislature have to resign on election to the Board of Directors. The Legislature is elected for political issues and there is no ostensible reason for its being approved as an electorate for the banks' purpose. Recent banking experience in Australia and South Africa shows us clearly that the retention of the legislature as an electoral constituency easily lends itself to party nepotism. It is indeed a truism to assert that "the party whip should find no place in the banks' parlour and the directors' meeting



should not be converted into a mere political dog-fight." But this is given up in the stockholders' scheme. The Board of Directors secures the independent element which not being recruited from the world of high finance would be free from the subservient tendency to vested interests. The Government nomination however secures the services of the people who are well-versed in public affairs and finance. Conflict between domestic and external capitalists is avoided by giving preference to indigenous and Indian domiciled capitalists. It is true that the stockholder's scheme does not go far enough. But it is quite in keeping with the practice of some of the foreign countries where it is distinctly laid down that persons not belonging to the nationality of the country of the Central Bank cannot either hold shares or exercise a vote. The regional directorate plan guarantees the representation of all provinces and the fear of the much dreaded influence of the Bombay speculators need not be entertained.

The necessity to pay the stockholders would undoubtedly tend to efficient management on the part of the Board of Directors. The co-operation of the Indian with the European businessman is also secured. The plan is largely Indian in character and Indian in outlook. Preferential treatment to the Imperial Bank in the allotment of shares is given up. The general interests of the inhabitants of the country who require stability of exchange as well as tolerable stability of internal prices are well secured. Lastly, it is free from the undue control of the Government which can only nominate a few of the experts to the Bank directorate to insure business ability. So long as the financial administration is still in the hands of the irresponsible executive, even the starting of a State Bank would be of little avail, for the Bank Executive free from the influence of the mercantile directors can manipulate the Bank any way it likes. Opportunity is given to the Associated Chambers of Commerce, Federation of the Indian Chambers of Commerce and the Provincial Co-operative Banks to elect directors. The introduction of the worst forms of racial and communal claims in the matter of election to the directorate is also negatived in this plan. Altogether the ideal of a non-official business institution independent of the legislature, Indian in domicile and Indian in character, has been approached nearer in this scheme than any of the alternative plans.

By accepting this scheme, or any modified form of it with all its salient features, India would have the unique distinction and honour of holding forth a new model for the Central Bank of Issue. Up till now most of the Central Banks of other countries have been based on a shareholders' basis, or they are State Banks or partly owned by the State and other banks such as the Swiss Bank where two-fifths of the capital is contributed by the Cantons, two-fifths by the public and the remainder by the old banks of issue. The Central Bank of the country though based on a shareholders' basis, should possess at the same time "the quintessence of the State Bank proposal" and if framed on a state-cum-shareholders' basis it should be so organised as to rob it of the chief demerits that are usually attendant on such plans. Most of the fundamental changes that have to be incorporated in any new plan should make concessions to public opinion as expressed in the Legislative Assembly, and it is apparent that the opinions of London high finance and the British commercial community must also be placated. The removal of the elected members of the Legislature from the body of delegates elected by shareholders in each province for the matter of election as directors is undoubtedly due to the intervention on the part of the India Office and pressure on the part of the foreign commercial community. Although the Indian Legislature might consider itself justified in persisting in its demand for its representatives on the Board and although it can successfully retort that the Government nominees on the Directorate can equally be considered as representatives of political influence, still in order to secure the co-operation of the London financial interests this essential point has to be sacrificed.¹ Without a spirit of reasonable compromise and hearty give-and-take in this vital issue it would be impossible to carry out this piece of legislation, the urgency of which need not be emphasised. Both the London financial interests and the Indian public have to modify their opinion and must arrive at a decision on this important topic. So long as the

¹ I am personally of opinion that the retention of the electoral college and enrolling Legislative Councillors as *ex-officio* members is a wise thing, for few men of business initiation, acumen and experience can be found outside this list. Even if they exist they would be so much engrossed with their own business so they would not care for the official honour. If after election they were to retire from the Legislative Assembly or Council there would be no real grievance and the London authorities ought to concede this.

financial control rests in the hands of the Secretary of State even a State Bank would be of little avail. So long as the policy of non-intervention is not pursued by the India Office in Indian affairs no real measure of autonomy can be enjoyed by the Government of India even though it be in substantial agreement with the Legislature. It is no use arguing that half a loaf is much better than no loaf. It is with a heavy heart that many of the economists regret the decision of the Government not to proceed with the Reserve Bank Bill and postpone *sine die* the formation of the Central Bank for the country. One may hope that the fires of parties and politics have burnt themselves out during the debates of the Reserve Bank Bill. It is up to impartial students of economics and other well-wishers of the public good to help that advent of a calm atmosphere which alone can secure initial agreement and subsequent co-operation in matters connected with the Central Bank.

The Working Model of the Central Bank.

In deciding the working policy of the Central Bank there are precedents of other systems which would have to be taken into consideration. It must be examined how far they may or may not prove applicable to this country. A recent writer in the Mysore Economic Journal¹ has classified the different Central Banks into three characteristic types, taking the method of operation as the basis of classification. There is firstly the instance of the Central Banks which act as the pure bankers' banks which, generally speaking, have nothing to do with the public but only confine their operations to the Government and the members of the banking structure. Secondly, there is the mixed Central Banking such as is done by the prominent European Central Banks like the Bank of France and the Reichsbank of Germany. Finally, there is the unique example of the Bank of England which always remains out of the periphery of the money market and intervenes on critical occasions to save the other banks and members of the money market from the ruin of an impending collapse of credit. This classification apparently is

¹ See the Mysore Economic Journal (May, 1927).

unscientific. Central Banks of Issue can act as bankers' banks without having anything to do with the general public. They can grant credit only in the shape of rediscounts. The Federal Reserve Banks of America, the Reserve Bank of Peru, and the South African Reserve Bank, the latter two of which are modelled purely on the first, are bankers' banks. This is generally referred to as the American type of the Central Bank. Central Banks can act as commercial banks and the loans and advances to others than the Government might form a major portion of their earning assets. The Banks of Issue of Canada, Brazil, Latvia, Esthonia, Australia, Russia and Greece, Uruguay and Egypt operate mainly as ordinary commercial banks. These are usually referred to as banks of issue modelled on the continental type. The Bank of England discounts for the general public at the market rate at all its branches. It attracts deposits from the general public although it pays no rate of interest.

Generally speaking the constitutional framework of the Bank itself and the work undertaken by it determines the method of its operations. A State Bank owned wholly or partly by the State and freed from the necessity to earn profits can pursue pure Central Banking or remain as a reserve or emergency bank meant solely to correct the mistakes of the other banks. The only physical point of contact between the man in the street and this kind of Central Bank consists in the former's handling of the Central Bank's note. A shareholders' bank would be forced to undertake mixed central banking in order to earn certain minimum rate of dividend for the share capital and thus reduce the overhead charges. It is indeed true that even an emergency bank would have to undertake open market operations¹ of a definite type so as to be able to control the credit situation

¹ There are two definite meanings attached to this word. In the wider sense it refers to all transactions of the Central Banks, i.e., purchases of bills from individual concerns besides their loans. In the narrower sense it signifies the sale and purchase of Government securities by the Central Banks on their own initiative in order to realise their own credit policy. A mere raising of the discount rate may be ineffective. At such times the sale of securities would absorb the available surplus and the "mopping" up of available funds takes place. Similarly when the collection of taxes means the return of large funds from the money market the stringency can be reduced by purchase of securities by the Central Bank in the market. In this country the purchase of sterling can act as a safety valve in reducing stringent situations in the money market. Thus the open market operations necessarily supplement and enforce the Central Bank's discount policy.



as soon as it is considered desirable to do so. Without limited open market operations no Reserve Bank can hope to control the credit situation. If the Reserve Bank fails to lend to the money market, the withdrawing of which amount would tighten credit there would be no real credit control. The Imperial Bank of Japan's permanent contribution to the available supply of banking capital is far from great. As the amount of its loans to the ordinary banks and to individuals during normal financial periods has been very small it is unable to control credit. As Allen says, "*this is a weakness in a Central Bank* for, it is obvious that if such a bank is in the habit of making large loans to the outside market in ordinary times, it has power to control the creation of credit during periods of excited trade, because it can, then, restrict its loans and so check speculation. This at any rate, has been the policy of Central Banks in other countries." ¹

(Although it is true that if the maximum rate of dividend, which the shareholders of the Central Bank of Issue can secure, is fixed in the charter of incorporation, it can undertake to act as a pure Central Bank confining its business solely to scheduled bankers, still the necessity of limiting competition on the part of the state-aided Central Bank with the ordinary joint-stock banks of the country has to be borne in mind. Even if the Central Banks conduct limited open market operations they ought to eschew unfair competition with the different banking institutions. Unless this advice is heeded the attempts of the Central Bank to control credit would be misunderstood. This is what has taken place actually in the F. R. Banking system of America during the formative period of its existence. The member banks "who were feeling the stress of competition accused the F. R. Banks of forcing money into the market which had no real need for it; of keeping the rate, *i.e.*, the rediscount rate below the open market rate and so tempting the member banks to borrow and relend profitably, generating a prolonged stock-market boom and bringing about a situation that is not conducive to safety." So the agitation there was to limit the open market operations. It is this ideal of pure central banking with very limited open market operations that has to be selected as the suitable model for our Central Bank of Issue.

¹ See G. C. Allen, "Modern Japan and its Problems." See pp. 156-158 (*italics mine*).

Possessing a few branches which can be opened at Calcutta, Bombay, Madras, Rangoon, Cawnpore, Lahore, Delhi and London, the Central Bank of Issue whether organised as a State Bank or as a Shareholders' one cannot hope to conduct mixed Central Banking. Besides, it would be unfair and impolitic to encroach upon and interfere with the business of the existing banks. If deposits are attracted from the businessmen these naturally expect the Central Bank to make advances and look after their business needs. This makes the Central Banker undertake commercial banking operations on a large scale and keen competitive conditions would ensue.

The ideal of the Bank of France as "the initiator of banking facilities" through more than 600 branches is placed before the public for due consideration and as this development of branches can be undertaken in this country by state-aided banks alone it is considered imperative that we should copy the example of this useful institution. Such has been the opinion in banking circles since the time of Hambro's minute in the Fowler Report of 1899. This is advocated afresh by Sir Purushotamdas Thakurdas in the Minority Report to the Hilton-Young Commission.

Circumstances seem to favour this idea, for the ideal of the Bank of England, the *grande dame* among Central Reserve Banks, which like Aristotle's God lives enthroned in magnificent isolation content to interfere occasionally, is eminently unsuitable to our country, for the indigenous banks are few and their working capital is small and the banking habit is undeveloped. Hence the useful privilege of rediscounting by means of which the ordinary banks can increase their working capital tenfold cannot and ought not to be sacrificed. But if continuous borrowing even for capital uses instead of temporary and emergency purposes is to be the object of rediscounting it has to be strongly condemned. In England the Big Five possess a large working capital which is several times greater than that of the Bank of England itself. So they are not enamoured of this privilege. Besides the practice of the English businessmen is to view this rediscounting with ill-concealed contempt. They have an innate dislike for their bills being "peddled" about in the market from door to door. They use bills as security for advances instead of selling them to the Central Bank.



The ideal of the Central Bank of our country should be on the other hand to operate continuously on a limited scale and always in a manner to interfere as little as possible with the privileges of the existing banks but yet secure the wider interests of the whole country. But the opening of branches in areas already covered by the existing banks would lead to competition with them and the Central Bank is not to be a competitor with the existing banking institutions. Again, the opening of branches in numerous places would lead to the scattering of the cash reserve. The real object of the Central Bank is to "accumulate a great central monetary pool" which has to be fed by diverse streams running into it. Resolute monetary control can be achieved by the custodian of the huge central stock and commercial operations should not be undertaken by the Central Bank of Issue and any first-hand relations except those that fall under the category of open market operations between the Central Bank and the trader are to be tabooed. Even if non-interest-bearing deposits alone can be attracted by it, it would still be forced to conduct operations of a commercial banking character which can be performed equally successfully by the ordinary joint-stock banks. It would not be free to pursue unhampered its particular credit policy, nor would its funds be highly liquid if loans are made directly to industrialists and businessmen who are the customers of the Central Bank.¹

The Work of the Central Bank of Issue.

Granted that this independent authority based on a stockholders' plan, free from political influence or that of the exploitation by sectional or party interests is created, it behoves us to study the actual work it would have to perform in the banking system of this country. Issuing notes or paper currency, watching the gold reserve of the country, controlling and regulating credit in the money market so as to satisfy the currency requirements according to the ebb and flow of trade and acting as the Government Banker, keeping its accounts, floating loans and remitting funds on its behalf to satisfy its disbursements, are some of the functions that the new institution will be entrusted with.

¹ See Kisch, "Central Banks," p. 105.

Note-Issue.

The Central Bank's sole object in issuing fiduciary currency is to confer all the well-known advantages of paper currency such as the economy of gold and its elasticity to suit the legitimate needs of trade and commerce. These objects are to be secured without at the same time subjecting the community either to the evils of artificial expansion, rising prices and speculation or the evils of artificial contraction, falling prices and depression on the other side.

The transfer of the assets of the Government of India to the Issue Department of the Central Bank would have to be made as soon as the Central Bank would be in a position to issue its own notes. Lest the popularity of the notes might be endangered, they would have to be double-guaranteed, firstly by the Bank and secondly by the Government of India. If the antiquated machinery of a bi-departmental system¹ is selected as the model for the Central Bank, the notes of the Issue Department would have to be handed over to the Banking Department only in exchange for other notes of the Bank or the Government of India notes, for gold coin and bullion or gold securities or rupee coin or Government of India securities or such bankable bills of exchange which are permissible as securities for the issue of the bank's notes. Each Department of the Bank would be liable for its own obligations. So far as the Reserve that has to be kept by the Issue Department of the Central Bank against notes is concerned, the suitability of the proportional reserve system or the fixed fiduciary system has to be considered. Since the Hilton-Young Commission's Report recommended the proportional reserve system and suggested that forty per cent. gold and gold securities have to be kept against these liabilities, those who are bent on opposition for opposition's sake have already raised the cry that the fixed fiduciary system and the backing of the extra

¹ The real danger of this system is the immobilising of the gold in the Issue Department and the real gold available to meet external demands would be held by the Banking Department and the whole of the pressure would be felt by the small and highly sensitive residue of the gold stationed in the Banking Department. A more effective credit policy can be pursued only by a combination of the two departments which would tend to make the reserve ratio less variable than before.



notes by metallic reserve is preferable to the proportional reserve system. Here again, as in the case of the organisation of the Central Bank, there is nothing but futile war of words. The fixed fiduciary system can be easily made elastic and flexible as it was done recently in England¹ and it can be made suitable even for agricultural countries requiring seasonal expansion of currency. Inasmuch as the economy of gold is the main criterion, the note issue has to be modelled on the proportional reserve system with proper safeguards to curb the easy expansion of notes ; for every note issued against gold means an actual loss. It would be a great inconvenience to the public to take bullion to the bank and get notes in exchange ; because the latter are so much easier to handle but the Bank has to take the trouble and expense of printing the note and guarding the gold without any compensation for the same. The proportional reserve system has already been accepted definitely by this country and embodied in the Paper Currency Amendment Act of 1923 (Section 18). It would certainly seem illogical to recommend the scrapping of this accepted feature.² The majority of the Indian people require however a fifty per cent. of gold coin and bullion reserve against the liabilities of the issue department of the Bank. This is the exact proportion of metal already recommended by the Paper Currency Act. Although the Government guarantee means³ that bank notes can embrace all the assets of the State ; the keeping of a lower metallic gold proportion than this accepted one would give scope for misunderstanding. Whatever might be the proportion accepted for the present, it is idle to attach any sacredness to the ratio of reserve. It is the general revenues of the State that form the backing of the note issue. As the upholders of the Banking School point out, no fixed minimum is necessary. Mere convertibility of paper into gold and *vice versa* is a sufficient

¹ See the Economic Journal, Sept., 1928, for the English Bank Note Act.

² The only theoretically approved plan of checking inflation of note issue is not to confer on them the legal tender privilege. As in the F. R. Banking system the bank note may not be endowed with legal tender privilege and this would make arrangement for its prompt withdrawal. The State can receive them in payment of public dues but they must not be made legal tender for private debts.

³ The mere technicality of Government guarantee is to secure their ready acceptance by the people. The real backing is gold and commercial paper.

safeguard. But the real danger lies in the draining away of the reserve and although it is true that, if sound banking exists no other quantitative restrictions need be imposed, yet in practice all countries have adopted this feature. In theory at least, they are guided by the currency principle, though their actual practice may conform more to the banking principle.

Whatever might be the proportion of the metallic reserve of the note issue, the method of note issue must be related to trade activity by permitting the Central Bank to issue notes against the security of bills of exchange. Issuing fiduciary currency against short-dated bills of exchange representing trade, industrial and agricultural activity is a sound principle adopted by almost all important countries. The circulation of such notes would confer the needed elasticity and in any other conceivable emergency¹ notes can be issued on the payment of taxation, even after the minimum legal cash reserve requirements have been touched. This process of extracting seasonal emergency currency would be less painful and more easy than at present when currency expansion can be secured sometimes unwillingly by the Imperial Bank pledging hundies into the hands of the Controller of Currency. This present-day elasticity is not only limited in volume to 12 crores but can be obtained by paying a stiff price. While in the past and

¹ Elasticity of note issue is needed during seasonal secular, and cyclical changes. Secular elasticity means power to expand so as to satisfy the needs of trade in long-time periods without destroying the value of money. No currency is elastic enough to prevent long-period fluctuation of prices. This is mainly due to rigid requirements of reserve ratios. Seasonal elasticity can be secured easily and American, Canadian and German note-issues present successful examples of seasonal elasticity. Cyclical elasticity of note-issue in times of crisis is also essential to allay the anxiety of the public. England provided this chiefly by the suspension of the Bank Charter Act. France generally raised the maximum issue. Germany and U. S. A. secured it by the method of levying a tax on temporary deficit of gold reserve in Central Banks. In 1928 England made provisions for emergency expansion with the consent of the Treasury. Some writers consider that even such abnormal emergency as a war has to be considered in the matter of note-issue regulations.

But purposeful control over the note-issue by discount rate, open market operations and moral persuasion is essential to tighten or expand the credit in the money market to satisfy the needs as the case may be. Until this is secured there can be no automatic elasticity of note-issue. An adequate self-regulated note-issue is a misnomer and except for seasonal needs there can be no such thing as cyclical and secular changes in note issue without disturbing the price level.



the present we have erred and have still been erring in the direction of too rigid and inelastic note-issue, in the future we might swerve to the opposite direction. So too many avenues should not be thrown open to secure the needed elasticity of fiduciary currency.¹

If "public satisfaction is a great asset in currency matters," as the Chamberlain Commission has pointed out, the keeping of a fifty per cent. metallic reserve against the note obligations would be essential. It would maintain the *status quo* recommended by the permanent provisions of the existing Paper Currency Act. Although a half and half security and metal basis is recommended for the note-issue, it is a mistake to suppose that a huge gold reserve is needed as a support to the note circulation. After all the gold reserve of the Central Bank is only a regulator fund. The volume of circulating media required in the country need not be based on this reservoir. Although the *raison d'être* of a reserve is to meet all demands and make the gold stock *an active reserve instead of a lifeless hoard*, still in reality gold withdrawals would be taking place for export purposes alone. Very little use of the gold reserve even for exchange purposes need be made if only there is stability or uniformity in the movement of comparative price levels. It is this that determines the exchange and not the size of the inert reserve lying in the hands of the Central Bank.

The Banking department of the Central Bank of Issue must also be forced to maintain a like deposit of 40 to 50 per cent. of gold or gold securities against the deposit obligations it undertakes. Without such a reserve aiding the Issue department of the Central Bank the reserves of the latter might be unable to bear the strain when notes are changed into gold at very short notice. It is the Bank of England alone which maintains a reserve against its note liabilities and gives full liberty to the banking department.

¹ Even Prof. A. C. Pigou, who is no staunch supporter of the doctrine that the trade cycle is a monetary phenomenon, points out the disadvantage of too easy elasticity of the proportional system of note-issue. It would easily lead to an intensification of the boom in trade matters and the facility with which currency can be supplied is an important factor in the amplitude of business cycles."—See his "Industrial Fluctuations." See also the Report of the 1918 Committee on Currency and Foreign Exchange in the United Kingdom.



Both the recently organised Reichsbank and the Federal Reserve Banks are bound to maintain a specific reserve against the deposit liabilities. The recently organised Bank of Poland contemplates a similar or like reserve of forty per cent. as against its deposit liabilities. In 1928 France adopted the minimum proportion of 35 per cent. gold backing for notes and deposits combined.

This is what has to be done even if the old-fashioned division of the Central Bank of Issue into two separate banks is adopted. *It would be far better to discard this antiquated ideal and modernise our monetary machinery by combining the two banks into one department of the Central Bank of Issue furnishing a simple consolidated statement of its accounts.* The superiority of this system has to be recognised. As the total gold held by the Central Bank can be easily placed at the disposal of the public, the certainty of pursuing a uniform credit policy always uninfluenced by the actual gold movements would be rendered possible. As the scope of the credit policy would be wider and the general interests of the country can be looked after in a more assuring manner, there should be a departure from the recommendations of the Hilton-Young Commission in this respect.

Deposits.

Another of my petty quarrels about the Reserve Bank Bill's specifications is this. The Central Bank of Issue should not be allowed to keep non-interest-bearing current accounts of the traders and individuals. We have already seen some of the reasons why deposits should not be attracted. As the Indian public place implicit faith in Government institutions there is the possibility of the Central Bank completely commanding the money market.

The Government of India should appoint this Central Bank as the sole custodian of its cash balances and it is high time to recognise that the maintaining of a separate Treasury system, even in a modified form, is unnecessary. Many of the Sub-Treasuries are "mostly revenue-collecting centres"¹ as Sir B. N. Mitra puts it. Reliable and trustworthy agents can be appointed to do this task of collection on behalf of the Central Bank of Issue. No danger need arise out of this

¹ Oral Evidence before the Chamberlain Commission.



step if it is declared unlawful on the part of the depositary or agent bank to loan out the public deposits. The joint-stock banks, indigenous or foreign, doing business in the country should be made to keep compulsorily a portion of their cash reserve, *i.e.*, $7\frac{1}{2}\%$ and $2\frac{1}{2}\%$ against their current or demand and time liabilities respectively. The banks need not feel sore at the cutting down of their reserve to this extent. As the rediscounting privilege would be thrown open to them there need be no specific grievance except that free and willing co-operation of these injured banks would not be voluntarily secured. The smooth and easy control of credit requires their hearty co-operation and so long as they are dissatisfied there can be no hearty co-operation on their part. At least permission might be granted that half of the compulsory deposit might be made in the form of short-term Government securities. The loss of this portion of their cash reserve through its transference to the Central Bank might occasion certain inconvenience but the great security afforded them through the existence of a Central Bank more than offsets it. These are the minor costs to which they would be subject for securing major improvements in the credit situation.

Cash Reserve.

With reference to the composition of the cash reserve some discretion should be afforded to the Central Bank specially in the formative period of its existence. While it can be insisted upon that during the march of a ten-year period a certain definite proportion of the metallic reserve is to be in gold, in the intervening period the Bank executive can be given a free hand in this matter. It would of course have to pay heed to public opinion and respect its sentiments by keeping its assets in liquid gold. But it should have wide discretion in regard to the amount of securities which can be readily turned into gold without any loss. But it should not be carried away by the short-sighted profit and loss philosophy. The purpose of the bank's cash reserve is not to secure profits and earnings but to enable the Central Bank to convert the bank's currency¹ into gold or

¹ It is the British doctrine of gold reserve that has to be copied. A reserve is meant to be used in times of emergencies. The Continental doctrine holds that gold reserves are to

standard money and if this duty is faithfully discharged it repays itself in many thousand ways, the chief of which would be the inspiring of confidence in the minds of the people. The greater the liquid gold ¹ in the reserve, the sooner will be the time when India can be placed on a real gold standard basis and some gold coin indication, not necessarily for extensive circulation, can be minted.² Without such a physical embodiment of the standard "gold rupee" it is not possible to convince the metallists of the existence of the gold standard and that currency regulation would in future be with reference to this gold standard.

Nextly, the ultimate right to sell gold for delivery at foreign centres must never be lost sight of. The key to the whole situation is this. On one side there is to be the Central Bank of Issue with complete convertibility of its note-issue. On the other there are the deep-rooted habits of the people to encourage the accumulation of precious metals. Gold is used as a savings fund. Unless the convention and the habits of the people change there is a grave peril to the gold reserve of the Central Bank. The Bank management would have to be cautious in charging the right price of gold at the bank. It must also be cautious in permitting the free use of the gold bars for all purposes, monetary as well as industrial. While these precautionary measures are justifiable the real gold backing of the bank currency which is the only thing understood by a layman should be steadily increased.

There might be certain occasions which would give rise to an external drain of gold. At such times the active gold premium policy may be judiciously pursued.³ Gold bullion has to be bought

be accumulated, advertised and admired. It is indeed strange that the U. S. A. pursued this policy and checked the payment of gold in redemption of F. R. Notes during the period of the recent war. See A. B. Hepburn, "A History of Currency in the United States," pp. 172 *et seq.*

¹ It was decided to have Rs. 10 lakhs reserved from the annual surplus solely for the purchase of gold bullion to enable the Reserve Bank to operate the Gold Bullion Standard with a certain amount of assurance. See India in 1926-27.

² This actual procedure is adopted by the French Government where the gold bullion standard was adopted in 1928.

³ It has its own attendant disadvantages for it tends to encourage the importers of specie as against importers of other commodities. It also tends to lower the gold import point at the expense of the Central Reserve Bank which pursues this policy. Thirdly if



by the Central Bank of Issue at Rs. 21-3-10 per tola and if the import of gold is to be stimulated it can, like the Bank of England, pursue the policy of buying gold at a slightly higher price per tola of gold.¹ Foreign gold coins can be purchased at a stated price or tariff and the price can be altered whenever the Bank wishes to encourage the importation of specie.² Both the Bank of England and the Bank of France pursue this system to encourage the free flow of gold into the country. Again the practice of interest-free loans on large gold imports can be pursued with the sole object of increasing the import of gold.³ Even the Bank of England pursues a similar policy in allowing the importer of gold bullion the use of money against securities free of interest for 10 to 14 days with the undertaking to pay in gold.⁴

Similarly there would arise occasions when the *import of gold* has to be checked by the Central Bank of Issue. At such times the import of gold has to be repelled so as to check gold inflation and the following recognised methods in this direction have to be followed. The Central Banks can deter the free inflow of gold shipments. When exchange is favourable and the gold import point has been reached the Central Bank of the country can purchase the exchanges of the other country and thus prevent the possibility of any profit on the movement of gold as a pure exchange transaction. The Central Bank can lower the discount rate and gold inflow can be stemmed by this procedure. The Central Bank can pursue delaying tactics and prolong the necessary formalities in assaying gold and cause the profit arising out of this transaction on gold shipments to practically disappear. It may even inflict a loss by pursuing this procedure. This is what the F. R. Banks have been doing during the autumn of 1928 when the prolonged boom on the Stock Exchange could not be curbed by raising the rediscount rate. In spite of

gold arrives before the maturity of the loan it tends to depress the rate of interest in the money market and would defeat the object of the Central Bank if it attempts to tighten the market rate of interest at that time.

¹ See the German Bank Inquiry Commission of 1908, p. 324.

² See A. C. Whitacker, "The Foreign Exchange," pp. 514-515.

³ See Interviews on Banking and Currency Systems of England, Scotland, France, Germany, Switzerland and Italy, N. Monetary Commission, pp. 28, 214, 357.

⁴ See the Hansard, p. 415, *Ibid*, quoted from "The Foreign Exchange."

deterrent rates the F. R. Banks could not secure a tight hold on the wild gambling tendencies on the New York Stock Exchange and any import of gold from the English consumers into the American banking system would have deprived them of the very little power they were wielding over the money market. Thus it is the acknowledged duty of Central Banks to take precautionary measures so as not to complicate the domestic situation by allowing free inflow of gold into the money market and tending to aggravate the speculative tendencies further.

Other countries will certainly set up the cry that India is "beginning to make a scramble for gold." They will look askance at the very reduction of the minimum quantity of bullion from the Hilton-Young Commission's high figure to that of 40 tolas fixed by the Indian Currency Act of 1927. But it must be remembered that even Ricardo in whom originated the idea of the gold bullion standard, never set up such a high figure as 400 oz. for the United Kingdom.¹ If the Central Bank is to pursue the well-known measures to attract gold so as to strengthen the gold holding of the country, the other countries should not misunderstand this action as calculated to drain away the world's supply. It is the bounden duty of our Central Bank to co-operate whole-heartedly with the other Central Banks for the purpose of securing the greatest possible economy of gold. International banking co-operation has become the order of the day and during the course of the last two years the elasticity and efficiency of international finance increased to a remarkable extent. Our Central Bank must move with this stream and current of international banking co-operation or be left behind.

Another reason why a high proportion of gold securities has to be kept by the Central Bank of Issue in the initial stages is that good commercial bills are scarce in this country and hence full freedom should be granted to the Bank Executive in this country. As pointed out elsewhere it would be keeping in conformity with the existing practice of all Central Banks of Issue created after the war. Interest-bearing foreign exchange is preferred by them to the holding of gold. Although it is easy to decry this tendency for stipulating a high proportion of liquid gold as displaying the old mercantilist tendencies in these enlightened modern days, we think it would be essential to

¹ His suggestion was for a gold bar of 60 ounces only.



keep this high proportion of liquid gold in order to satisfy the layman who requires a solid and visible backing for the currency he uses. He would certainly misunderstand any large holding of silver in the reserve of the Central Bank. He would consider the standard to be still the "independent silver rupee standard." If the gold bullion standard means any real change from the old monetary standard the silver assets would be an encumbrance. They would be of assistance to the bank only so long as there is demand for the silver rupee. Increased amount of Silver Rupee Coins should not be held. We must decry the attempt to dominate the new bank note-issue in terms of increasing quantity of rupees beyond the one recommended by the Hilton-Young Commission. This attempt is nothing but an unwise perpetuation of the state of "dyarchy" existing in our currency organisation. All this has arisen on account of the Hilton-Young Commission's failure to keep the old Paper Currency Issue and the new bank note-issue logically separate. As has been suggested a separate provision for the Government notes and for bank notes would have been far more logical. Although it is in the interest of India to proceed slowly in the matter of demonetisation of the silver rupee still increased holdings of the rupee stock would not give much confidence. After all the bank's liability is to pay in gold bullion and not in silver so the rupee stock need not be maintained on a large scale. Why then keep more rupees in the reserve for notes expressed in terms of gold? The liability for the redemption of the rupee is indefinite and would grow less with time and the people would be forced to circulate it to satisfy their increasing commercial needs. Any undue increase in the holding of silver rupees on the ground of excessive holding of silver rupees at the present-day composition of the Paper Currency Reserve will perpetuate for a very long period our bondage to silver. What is required is that people should be inured to the use of bank notes and curtail their dependence on silver as early as possible. When the psychological moment arrives it can then be declared no longer legal tender. This demonetisation has to be effected as soon as circumstances are propitious. It is quite possible that the new bank will be confronted with large and increasing quantities of rupees issuing out of hoards as the people begin to realise that it is the consistent policy of the Central Bank to popularise the Bank note. Surplus rupees would have to be returned to the Govern-

ment who would have to convert them into gold securities out of assets obtained from the sale of silver or by borrowing for this purpose.

The holding of Government of India Rupee securities in the reserve as it is now done in the P. C. Reserve has to be continued though to a limited extent, and a margin must be left for the holding of legitimate commercial bills. The prime desideratum is to leave the Bank the greatest possible freedom from mechanical restrictions in pursuing its reserve policy. Otherwise the rigid adherence to laws regulating the composition of the reserve would curtail the independence of the Bank Executive and as they would have to manage this bewildering miscellany of gold, domestic and foreign bills of exchange, silver rupees, Rupee securities (a relic of the old regime) and gold securities against the note-issues, any attempt to fix rigid restrictions as regards their respective amount would be futile and the Bank executive would only be pursuing a will-o-the-wisp. One fails to see what the real benefit would be in suggesting the incorporating of rigid restrictions in the respective holdings of the metallic reserve which can only be realised after a lapse of 10 to 20 years.

The Rate of Discount.

This is the chief means at the disposal of the Central Bank of Issue which enables it to maintain the due proportion between the gold holdings, the note-issue and the volume of credit. The administration of the discount rate policy of the Central Bank should be broadly speaking on lines similar to those adopted by other gold standard countries. Domestic inflationary and speculative tendencies, the volume of credit, the movement of prices, the level of foreign exchanges, the trend of domestic economic conditions and changes in international business conditions must influence the decisions of the Board of Directorate of the Central Bank in fixing the bank rate. The percentage of cash reserve or gold holding alone should not be the sole determinant of the bank rate.

There are two illustrious examples before us and the suitability of the first or the second method in fixing the bank rate would have to be discussed in detail. Normally speaking in England the bank rate is above the market rate of interest on similar types of commercial paper. In the U. S. A. the discount rate does not follow the

above rule but it ranges between the open-market rates for ninety-days bankers' acceptances and 4 to 6 months' commercial-paper. As Burgess puts it, "the discount rate moves within a ribbon whose borders are the commercial-paper rate and the open market rate for bills."¹ Although the two countries charge the discount rate on quite different principles "the cost of obtaining reserve funds is relatively the same and not far distant." This has been due to the fact that "a fair price is charged for the reserve funds."

Which of the two precedents can be of use to our Central Bank? Have we to discard both these precedents on account of our very different banking organisation? The Bank rate which the Imperial Bank charges is the rate on advances against Government securities. The Imperial Bank hundi rate is the price charged for discounting hundies and the bazar rate for hundies is sometimes lower and sometimes higher than the Imperial Bank hundi rate. When necessary the indigenous bankers or shroffs sell the hundies to the Joint-Stock Banks or the Imperial Bank. The ordinary Joint-Stock Banks usually charge a higher rate than the bank rate for advances. As this situation is different from that obtaining in England or America the suitability of their bank rate policy has to be discussed in detail.

In the Indian money markets there are no bill markets. The market here means rates on customers' loans made under cash credit system. The rates for such loans are not strictly highly competitive. These rates are not published but are known to the Imperial Bank and they may be uniform in the important national money markets. It is these customers' loans that would have to be rediscounted with the Central Bank of Issue until a bill acceptance and open market is developed. This rediscount rate for loans ought to be different and higher than rediscount rates for hundies and a few bank acceptances that might be created. *In each of these cases the rediscount rate should be higher than the market rate for that particular type.* Until a bill market is developed and bills are held in the portfolio of the banks as their secondary reserve the rediscount rate for acceptances will not become all important. When these are to be had in sufficient quantity the rediscount rate can be kept far below the rediscount rate for loans or advances on Government Paper or commercial

¹ See W. R. Burgess, "The Reserve Banks and the Money Market," p. 191.

paper based on the cash credit system. *In all these cases of rediscounting the Central Bank's policy should be not to make money artificially low or artificially high. In such a case the true equilibrium will be destroyed.*

The English Bank rate ¹ is a penalty rate and dissuades members from borrowing by this means. Again there is a uniform market rate there which banks charge their customers. Such rigid uniformity does not exist in any of the money markets of this country. Besides there is no competitive market for money. Hence the problem of levying a penalty rate would not be easily solved. But this much is certain. Whenever scheduled banks tend to overborrow this penalty rate has to be imposed.

If this be not acceptable it remains to discuss the possibility of accepting the second method. Although our hundi approximates closely to the commercial paper of the American money market still the bill rate does not exist for few bills are drawn in internal trade transactions and accepted by the banks. Besides there is a tradition which exists in the American money markets which dissuades the member banks to borrow on all occasions.² It is not only true that the Central Bank, i.e., the F. R. Banks, carefully scrutinise their position but some suspicion, if not aspersion, is cast against these habitual borrowers and no bank can hope to run counter to this wholesome and desirable public sentiment. *Without such a tradition it would be impossible to deter our scheduled member banks from freely tapping the central reservoir on all occasions and making a too free use of the rediscounting privilege and thus tend to destroy the liquidity of the banking system.* Hence it would be dangerous to keep the bank rate always lower than the market rate for bank acceptances. Inasmuch as the member bank's endorsement is to be had in the case of discounting by the Central Bank the price for this endorsement has to be ascertained. If the Central Bank charges a rate which represents the true value of the bank's endorsement, there would be no temptation to the scheduled or member banker to borrow except for legitimate purposes.

¹ The Central Bank of Switzerland, the Bank of Sweden, the Bank of France and the Bank of Germany similarly maintain their Bank rate at a higher level than the market rate. This is the policy of almost all European Central Banks.

² See Mr. A. Bowie's Evidence before the Hilton-Young Commission.



The true value of the bank's endorsement and the right discount policy can be discovered by a process of trial and error just as has been done by the Federal Reserve Banks. The Central Bank's discount rate will be between the bazar rate for hundies and the price charged for bank acceptances by the bankers in the open market. When once this open market rate for bank acceptances has been arrived at the other money rates in our national money markets should be practically moving in relationship with the discount rate. Nothing higher than a fair price has to be charged by the authorities of the Central Bank. To facilitate bank acceptances a lower rediscount rate than in the case of commercial paper can also be adopted successfully.

The commercial bills that can be discounted should be short-term self-liquidating bills representing *bonafide* commercial transactions. Discriminatory rates of interest higher than the bank rate should be imposed on advances made on bonds¹ and stocks as collateral for these advances are mainly and too often, used for fixed capital or speculative purposes. The bank rate policy cannot be effective unless there is an active discount market and every attempt must be made to develop an active discount market.² An active discount market can be created by low rates of interest on the part of the Central Bank and activity on the part of the indigenous bankers, shroffs and banks in accepting, buying and selling freely the bills of exchange. Bank acceptances arising out of foreign trade transactions should also be rediscounted by the Central Bank. Bills can be used as collateral for securing loans from the Central Bank whenever it is possible to do so. If these methods are adopted it can be seen that a satisfactory development of the discount market would continue. These were some of the very methods adopted by the Nederlands Bank to create a discount market in the country.³ The Central Bank of Issue should always possess a portfolio of best bills of exchange or of a relatively small amount of most desirable forms of short-term Government indebtedness to be used for mobilising funds from the market or

¹ These are known in the London Money Market as Lombard Loans and the Bank of England charges a higher rate than the official rate.

² See the chap. on Banking Organisation—Sect. on—Bills of Exchange.

³ See the English Edition of the Report of the Nederlands Bank—1926-27—quoted from the Economic Journal, Dec., 1927, pp. 622-624.



“mopping up” the surplus when it is considered necessary to control the other money rates in the money market. *A stable rate of discount is of the greatest importance to the nation.* It should be raised, not needlessly, but only when economic conditions such as unfavourable exchange, volume of production, domestic speculation, activity on the stock exchanges and high rise in the general price-level demand such an increase. At such times it has to raise the bank rate to any height, whatever might be the state of the reserve, if the volume of credit fails to call forth a corresponding increase of production and when speculation and inflation begin to take place. The Central Bank should discount liberally but always at a high rate during the period of a crisis and this is the only method by means of which the disastrous consequences of a crisis can be averted. As MacLeod says, “the restriction theory in a commercial crisis is a fatal delusion. The only way to avert an impending panic is to give prompt, immediate and liberal assistance to all houses which can prove themselves to be solvent, at the same time allowing all houses which are really insolvent to go.”¹ The Central Bank should not raise its discount rates during purely ‘seasonal drains’ which are quite different from the “foreign drains” and “speculative drains.” A recent writer prepares a chart to show the seasonal trend in rates of interest. Both the monthly averages and the general averages for all months are useful for the administrator or the Government Officer-in-charge of the Paper currency machinery and to whom is entrusted the task of providing seasonal currency. *The task of issuing additional currency in the busy season is the sole duty of the Central Bank which is to act as the currency authority at the same time.* It is floating credit that is required by the borrowers in the money market. Whenever there was an abundance of such floating credit the bank rate never rose to a higher level than 6 per cent. in our money markets. This was the case during 1914-15, 1917-18, and in 1925-26. So a liberal supply of note and deposit currency at that time would suffice and the Central Banker can easily provide such emergency currency at the time of periodic calls in the busy season. This is the ideal and universally accepted solution.

¹ See H. D. MacLeod, “Elements of Banking.”

If an abnormal feature like the Government management of currency were to exist it would be incumbent upon the Government administrator to provide emergency currency at a scale of charges acceptable to the business public. But there is no need in this book on banking, which insists only on the ideal arrangement that has to be attained, to discuss the scale of charges which the Government (currency authority) have to bear in mind in providing emergency currency. Seasonal emergency currency must be secured not only in a sufficient quantity to satisfy legitimate needs of trade but also at a rate compatible with the economic interests of business.

The keeping up of the exchange value of the Rupee at 1s. 6d. and the par points round it would be one of the bounden duties of the Central Bank and the most helpful thing in this direction, apart from the credit control it can exercise, is the acquisition of a portfolio of foreign bills drawn on the gold standard countries. This is the only safe method of rectification of foreign exchanges apart from control over internal credit situation. Active buying and selling foreign exchange when the market rates deviate from the normal specie points is the only method of stabilising exchange within the specie points.

Mr. B. B. Dasgupta says that neither in Mr. Shirras' otherwise useful work and Mr. Rao's recent study of Indian banking—except in Mr. Keynes' book—do we find the quantitative measurement of seasonal fluctuations or any thorough attempt at dealing with the questions of periodicity. My book deals solely with the banking system of the country and apart from pointing out the defective nature of the present-day seasonal emergency currency much scope would not be forthcoming in a work of banking alone to deal with currency also. Mr. Keynes was writing on both currency and banking and the specialised attention that I had to pay to banking features alone made me pay slight attention incidentally to this emergency currency. Even now, I am of opinion that this supplying of currency at times of seasonal periodicity is the most inefficient method of providing currency to meet seasonal demand. It is credit currency that ought to expand and there is no necessity to impose a heavy burden on businessmen by charging a high bank rate. In his attempt to point out the scale of charges for the successful administration of emergency currency, he has altogether forgotten the ideal of a steady bank rate and the expansion of credit currency by the Central Bank. It is indeed deplorable that he has grasped only the shadow and not the real substance. Both in pre-war Germany and Canada whenever such seasonal demands for currency arose there was no penalty bank rate imposed in any one of the above countries. It is a matter of common knowledge that pre-war Germany allowed extra issue of 200,000,000 marks at the end of quarters. Canada still permits an overissue of bank notes up to 15% of the combined capital plus surplus in addition to the notes outstanding at the opening of the season. Seasonal elasticity was thus furnished through flexible bank issue rising and falling automatically to meet the needs of trade.

This was how Austria stabilised the exchange value of the Krone during the years 1923-26.

Foreign gold bills are considered as valuable assets, important substitutes or complements to the metallic reserve and form a part of the foreign assets of the Central Banks of other countries. First rate Government securities and book balances in foreign centres are considered as *legally* equivalent to gold. The following table shows the foreign assets and gold held by some of the Central Banks

(Figures in Millions.)

Name of the Central Bank.	Domestic Currency Unit.	End of 1913.	1924.	1925.	1926.	1927.
Union Bank of South Africa.	£ { Gold Foreign assets	8.2 ...	12.3 2.2	10.2 6.3	9.7 6.3	10.2 7.7
National Bank of Egypt.	£.E. { Gold Foreign assets	2.1 1.6	3.4 48.9	3.4 42.2	3.6 31.0	8.8 31.3
Canadian Chartered Banks.	\$ { Gold Foreign Assets	46 87	67 112	88 209	99 259	98 219
U.S.A. Federal Reserve System (excluding gold certificates).	\$ { Gold Foreign Assets	... ...	2,242 ...	1,940 ...	2,051 ...	2,030 ...
Bank of Brazil	Milries { Gold Foreign Assets	... ...	450 300	454 113	471 337	407 362
Bank of Republic of Columbia.	\$ * { Gold Foreign Assets	... ...	9.6 13.7	15.0 21.3	18.4 24.6	20.5 23.7
Bank of Japan	Yen { Gold at Home Gold and F. A.	130 246	1,201 329	1,155 258	1,127 230	1,087 186
The Reichsbank of Germany.	Gold Mark. { Gold Foreign Assets	1,170 208	760 1,198	1,208 1,016	1,831 963	1,565 472
The National Bank of Belgium.	Belga { Gold Foreign Assets	346 232	378 42	380 42	620 447	719 525
The Bank of France.	Franc { Gold Gold abroad Foreign Assets	3,517	3,681 1864 69	3,684 1864 64	3,684 1864 85	3,681 1,864 51
The National Bank of Greece.	Drachma { Gold Foreign Assets	25 227	64 793	66 1121	20 1388	76 1,365
The Bank of England.	£ { Gold Foreign Assets	35.0 ...	1,28.6 ...	1,44.6 ...	1,51.1 ...	1,52.4 ...
The Bank of Sweden.	Krona { Gold Foreign Assets	102 122	237 137	230 202	224 208	230 264

*(Figures in Millions.)*

Name of the Central Bank.	Domestic Currency Unit.	End of 1913.	1924.	1925.	1926.	1927.
The National Bank of Switzerland.	Franc { Gold Foreign Assets	170 38	506 193	467 222	472 222	517 198
Italy : 3 Banks of Issue.	Lira { Gold Foreign Assets	1,376 197	1,550 157	1,553 192	1,563 642	1,593 1,078
National Bank of Roumania.	Lei { Gold at home Gold abroad	152 ...	135 428	139 428	144 428	150 428
The Commonwealth Bank of Australia.	£ { Gold Foreign Assets	4.5 ...	24.9 41.1	26.3 49.1	22.0 54.3	20.7 55.0
The National Bank of Austria. ¹	Schilling { Gold Foreign Assets	... ...	11 366	15 567	53 683	84 653

From the above table it is apparent that the recent tendency of most of the newly established banks is to substitute interest-bearing foreign exchange for gold.² Some of these Central Banks hold more foreign exchanges than gold. The use of interest-bearing substitutes for gold instead of a high proportion of idle specie is also a well-known practice of the Central Banks of Issue. They clearly recognise that the gold reserve is a cause of waste for the Central Bank.³

¹ See the International Statistical Year Book—1927—The League of Nations, pp. 180 and 183. See also the monthly bulletins of the F. R. Board of the U.S.A. Reports of Central Banks.

² See the rules guiding the cash reserve of the Bank of Albania—"Gold not less than one-third should be kept against note-issue. The Board of Directors have the power to determine the place where the reserve shall be deposited. On the decision of the Board of Directors part of the said Reserve, which may in no case exceed two-thirds of these, may consist of stable gilt-edged foreign securities. By the term "foreign securities" is meant (a) foreign bank notes not subjected to unusual fluctuations in exchange, (b) foreign treasury bills payable in gold or in specie not subject to unusual fluctuations, (c) bills of exchange expressed in foreign valuta not subject to unusual fluctuations payable on the leading markets of Europe and America at not more than three months and endorsed in every case by two persons signatories to the bill and of recognised solvency or by a bank of undoubted solvency. Foreign securities may also consist of assets and funds available at any moment and without restriction deposited in banks of undoubted solvency in the leading markets of Europe and America. (See Spalding, "Dictionary of World's Currencies and Foreign Exchange," p. 3.)

³ According to the Federal Reserve Board's calculation (March, 1927) the leading Central Banks held liquid foreign assets to the amount of some one billion six hundred million dollars, of which approximately one billion were held in the U.S.A.

✓ The rationale of this tendency to pay greater attention to foreign exchange reserve and keeping it higher than actual gold reserves is simply this. The main advantage in this portfolio of foreign bills is that adverse foreign exchanges can be met suitably without raising the bank rate and contracting credit and prices. This is one of the well-known and desirable methods of the Central Bank to prevent fluctuations in the bank rate.¹ The holding of the securities is not so advantageous as the holding of the foreign bills. Securities cannot be sold for large quantities without suffering some loss. Even the Bank of England was often advised to keep a portfolio of foreign bills.²

Foreign gold bills are international currency. The apparent danger in this step is that in times of war this country might be cut off from the financial centres in which the assets have been piled up.

It is the duty of the Central Banker to bring exports and imports into a normal balance. In case of unfavourable balance the play of natural correctives can be invoked. Exports can be stimulated by encouragement of home production and industry. Artificial restraints on trade can be rectified. Internal prices can be made to move in line with international prices so that foreigners may find this country a good place in which to buy. Such measures must be taken by the Central Bank of Issue so that the unfavourable balance of trade would not first of all reduce the foreign credits of the Central Bank maintained specifically for the stabilising of the exchange rates. Secondly, the drain of gold from the country would endanger the ability of the Central Bank to control the credit situation. Foreign loans can be arranged in times of excessive fall in exchange rates. If foreign credits do not prove sufficient to support exchange, recourse to foreign loan can be arranged and if supplemented by internal loans the unfavourable balance can be corrected easily. The proceeds can be utilised to build foreign credits for supporting the rate of exchange. With the requisite control over internal prices they can be soon brought back into a line with the world prices, and exchange rates ✓

¹ See Liesse, "The Evolution of Credit and Banks in France," p. 231.

See also Whitacker, "The Foreign Exchange," p. 574.

See also the Renewal of the Reichsbank Charter, pp. 35-40.

² See the London Banker's Magazine, October, 1903, p. 443. Note also the reply of Sir R. H. I. Palgrave to this suggestion in the Economic Journal, December, 1906, p. 580.



would then tend to remain within the par points. As soon as this is reached, the Central Bank can recede from the foreign exchange market.

The Internal Credit Policy.

Credit regulation by a Central Bank of Issue would be an entirely new innovation in our money market. Clear-cut conceptions should exist as regards the desirability of such control and the means of controlling the general credit conditions should be well-understood by our people. The continuous regulation of the credit conditions should be in the wider interests of the public welfare. The rate at which credit is created should be high enough to protect gold reserve and prevent inflation but yet not so high as to depress domestic business or make it impossible to relieve trade depression. All the operations of the Central Bank should be guided by the sole principle of accommodating the legitimate needs of commerce and trade. There should be no favouritism to particular customers nor any special touting for business. All borrowing banks, whether big or small, should be treated alike and credit placed at their disposal at a uniform rate applicable to all. With proper information collected from original sources from the published reports of central trade associations by a qualified research staff as regards business conditions, labour employment and unsold stock, the Board of Directors of the Central Bank has to regulate its credit policy on the basis of this economic data before them. For a long time to come mere rule-of-thumb methods would guide the determination of the credit policy. But any due and adequate business accommodation can actually forthcome as a result of its proper understanding of the conditions of the borrowing banks, money market rates and conditions, gold movements, movement of funds inside the country, broker's loans, interest rates of banks and shroffs, savings bank deposits, condition of foreign banks of issue, money rates abroad, foreign exchange rates, domestic and foreign financing, sales and stocks of business houses. The Central Bank would have to collect all this data from the different parts of the country, and covering over a wide range of business and banking interests. The ordinary Banks would have to issue monthly circulars dealing with monetary and industrial affairs of their customers and more trade associations, as the jute and tea traders possess, would have to furnish reliable data to the

Central Bank of Issue. Sheltered Industries would have to do likewise. Employers of factory-type industries would have to co-operate with the Central Banker and enable him to know the volume of production and the pace of its development. The Government itself would have to issue a more accurate general purpose index number including wages, rents, cost of living ¹ and wholesale prices, which reflects the state of purchasing power more clearly than an index number of wholesale prices alone. The major trades and industries can pursue rationalisation and price stabilisation programmes thus indirectly aiding the Central Bank in its attempts to level down serious fluctuations in commodity values with all their attendant and disastrous effects on labourers, the consumers and the general investors. They can also co-operate in the conducting of a census of industrial wages.

An enlightened regard for national interests must be the cornerstone on which the business of the Central Bank should be conducted. It should create credit adequate enough to satisfy the legitimate requirements of business. The financing of industry or agriculture should receive due and adequate attention. The increase of co-operative paper that can be discounted is a real necessity, and once this is secured the agitation for an All-India Apex Co-operative Bank would become unnecessary. The extension of the term of the co-operative paper that can be discounted from the Provincial co-operative Apex Banks by the Central Bank can be limited to nine months and any extension beyond one actual season's period has to be deprecated. A judicious renewal of such paper to deserving Provincial co-operative Apex banks would meet with the situation. A Central

¹ It is impossible to construct an all-India Index-number until accurate statistics of prices are available. The construction of an Index-number by the aggregate expenditure method is feasible and its results might be checked by a collection of family budgets. The Bombay Labour Office published its Index-No. of the cost of living of the working classes in 1921. In Bihar and Orissa Index-Nos. are being framed at six centres. The Labour Statistics Bureau was established by Burma in 1926 and only just recently the cost of living of the working classes has been analysed and separate Index-Nos. have been worked for each class (1928). Now that the Provinces have established an agency for collecting statistics of prices the construction of an Index-No. according to the aggregate expenditure method must be done and the "weighting" of the commodities of consumption must be done from statistics of imports, production and exports in the case of India as a whole. This would give a fairly reliable indication of inflation or deflation and serve as a guide to the Central Bank policy.



Bank requires high-grade commercial paper which is promptly paid and the completion of each transaction should have an automatic effect on the bank's currency.

It is also inevitable that until a discount market is developed the rediscounting of the few available hundies and bills would not satisfy the needs of the situation. For several years to come loans to scheduled banks against promissory notes and under adequate safeguard will remain the major form of the accommodation which the Central Bank of Issue can give to help the financing of the crops and industry. Our inland trade which is roughly ten to fifteen times larger than our foreign trade is mainly financed by promissory notes on demand backed by good names, no doubt, but without any due date fixed therein. Such instruments, however can be rediscounted. Trade promissory notes representing actual sales and drawn for a period of three months should be freely rediscounted by the Central Bank for the scheduled banks. The quality of credit would be practically at the discretion of the scheduled banks and it is over the volume of credit that the Central Banker can exercise his influence. The scheduled banks would borrow as soon as their cash position is deficient and the Central Banker cannot afford to influence the character of employment of credit created by him except in so far as the type of eligible paper is presented by the borrowing banker for securing the credit. As the initiative lies in the hands of the borrowing banks some methods of curbing their anxiety to tap the central reservoir of credit should be devised. Traditions against continuous borrowing do exist in our market to a certain extent but much reliance cannot be placed on this traditional tendency. The Central Bank must be armed with measures which enable him to check this undue creation of credit. The bank rate weapon and the open market operations are the usually recognised means for this purpose.

Loans.

The maintenance of a minimum reserve to be kept by the incorporated banks with the Central Bank involves the obligation to make loans to them and thus follows the necessity to be on guard against bad loans. This would introduce standardised methods of accounting and reporting and must duly bring in its train the need for examina-

tion by the Central Bank. This would be a new but very wholesome innovation in Indian banking practice. A staff of bank examiners who would be co-operating with the other examining authorities of the joint-stock Banks¹ would have to be created to ensure the safety of the loan. Extensive credit files would have to be maintained and the weeding out of the incompetent and inefficient member banks would have to be rigorously done. The Central Bank policy should always be to extend to each scheduled bank borrower such discounts and advances as may be freely and reasonably made with due regard for the claims and demands of other member banks. Impartial service to all borrowing banks should be the watchword of the Central Bank.

Loans ought to be made for a limited period to Bank borrowers on the security of gold or silver or documents relating to their shipment or storage or on negotiable paper as can be discounted by itself or against merchandise stored in the bank's godowns or bonded warehouses to the extent of two-thirds of its value or against Government and Trustee securities² or foreign bills that can be discounted by the Central Bank itself. The short-term advances that can be made to the Government must also be limited in amount and no such advance ought to remain uncollected at the end of twelve months. At present there is no open market for the Treasury bills and it would be the cardinal duty of the Central Bank to encourage dealers to buy and sell Treasury bills and always stand ready to purchase T. bills from the dealers when the market becomes congested or when money becomes firm with the result that call money cannot be secured from the banks at a cheap rate to finance their transactions. The Federal Reserve Banks always undertake to purchase their T. Bills from dealers at such times and this is done on the undertaking that they repurchase them at the end of fifteen days. Thus the dealers buy and sell the T. certificates at the market price and the creation of this market made the T. certificates a desirable form of employing surplus funds. The absence of such a market for T. bills is the chief disadvantage and the Government are not aided in the matter of their short-term debt by the money market and high prices are being paid for their sale.³

¹ See chapter on Banking Legislation.

² See chapter on "Recent Monetary Reform."

*Investments.*

The Central Bank's own investments can be made in Government and Trustee securities repayable at the end of ten years and a sum not greater than the paid-up capital plus the reserve can be locked up in such investments. The list of securities which the Central Bank can buy must be carefully defined and it should consist of bonds and Treasury bills or notes of the Government of India, provincial Governments, Municipal and District Board Bonds, Port and Improvement Trust debentures.

Quasi-Government and Government securities should form the principal items of investment. What the Central Bank has to do in the matter of creating an open market for Treasury bills has already been related. Herein it is not outright purchase that is advocated and in the case of the policy guiding its investments outright purchase and sale of these securities is involved. This is defined as the open market operations of a Central Bank of issue which is acting solely as a "reserve" bank. The purchase of bills and securities is meant to release credit into the hands of the sellers of securities who deposit the same in their banks which in turn might deposit it in the hands of the Reserve Bank as a portion of its reserve funds. But no great increase of credit will be forthcoming if the depositing bank pays off its obligations to the Central Bank. Even if the depositing bank issues credit against its reserve in the Central Bank this finds its place in another bank which owes obligation to the Central Bank. So the practical result is that there is no great increase in the total volume of bank credit that can be created out of the Central Bank's purchase of Government securities. Again this involves retrenchment in Central Bank discounting and the total credit thus created would be the same as before.

By selling bills and securities it receives payment on a bank balance lying with it. It leads to reduction of the reserve of the purchasing bank and with its lesser reserves it cannot continue extension of banking accommodation as before. So it borrows from the Central Bank or collects its assets from buyers who have to borrow from the Central Bank; so the net result, which is the same in either case, is brought about only in an indirect manner.

This voluntary purchase and sale of bills and securities is not meant for adding to the profits, for Government securities actually yield less than advances to banks, and it is only when rediscounting or borrowing by scheduled banks is not conducted that there would be the possibility of securing earnings. Inasmuch as the purchase and sale of Government securities leads to release or tightening of credit this policy has to be pursued in order to make the bank rate effective in controlling the money market. There should be a uniform policy in the matter of the open market operations which are conducted by the different branches of the Central Banks. Neither should an artificial market for Government securities be created nor should any opposition to Treasury financing be created by this method of un-co-ordinated open market operations of the different branches of the Central Bank. High level business, active speculation, labour shortage, rising prices and excess production are the usual signs when sales of securities can be undertaken to increase banks' indebtedness to the Central Banker and thus restrain their credit creation. Depression of agricultural prices, and business conditions and disturbed psychology are the criteria for pursuing the purchases of securities. These are the data by which the open market policy of the Central Banker should be guided. Without such enlightened policy the needed stability to the credit structure cannot be imparted and credit control cannot be secured and rendered effective.

Buy and sell Gold.

Buying and selling gold without limit at a stated price is another lawful duty which most of the Central Banks discharge. The gold bullion market can be maintained in this country without much difficulty as it annually absorbs about half of the world's production of new gold and one-third of the world's production of silver. The annual production of world's gold amounts to 600 tons and its value amounts to a little over £80 ms. and the production of gold is also fluctuating and might be on the decrease. Of this total amount about half is produced from the South African gold mines. Although gold goes direct from Durban to Bombay, still it is a part of the transaction of the London gold bullion market. There is no gold bullion market in New York in the sense that it exists in London.

In spite of the several handicaps during the war period such as the hindrance to gold movements during the war, the embargo on the export of gold from 1920 to 1925, and the depreciation of sterling, London did not lose its pre-eminence as the world's gold bullion market. An effective restoration of the gold standard presupposes the restoration of the free gold market in the country. Gold arriving in London is sought either for satisfying the reserve needs of the Central Banks or in catering to the "industrial needs" of the people. The movements of gold are also dependent on the quotations of the exchange market and the essence of the gold standard is the intimate relationship that exists between the gold movements and the rate of exchange. The London bullion brokers and merchants study this relationship carefully and the "distribution of new gold," says Hawtrey, "is always the result of their nice and minute calculation referring to several countries."

If a free gold bullion market is to be created in this country it can only be done by a thorough application of the principle of the gold bullion standard. The Central Bank must be willing to buy and sell gold in the country at any time according to the obligation imposed on it.² The mere keeping of a high proportion of gold in the metallic reserve portion of the bank would be futile so far as the creation of a gold market in this country is concerned. The price at which gold should be sold should not be unduly high and when India has a large favourable balance of trade it can be turned into gold freely and practically under the new provision of the

¹ For more details concerning the distribution of the world's output of gold, see R. G. Hawtrey, "The Gold Standard in Theory and Practice."

² The Master of the Bombay Mint can also accept gold at Rs. 21-3-10 per tola of the fine gold whether refined or unrefined, which would be melted and arranged upon receipt at a charge of 2 pies per tola gross weight of refined gold. No gold bar exceeding (3,200 tolas) will be accepted (1,200 oz.). As in the case of the Bank of England's purchase of gold, 95 per cent. of the value of gold tendered will be made in receipt of gold. If the Master of the Mint is satisfied a preliminary certificate shall be issued. It is not essential that free mintage should exist in any country to maintain a free gold market. The essentials of a free gold market can be secured if the Central Bank can purchase and sell gold bullion at a standard price in any quantities offered to it. Since these lines have been written importation of gold sovereigns took place into this country even though the gold import point of the rupee was not reached in the foreign exchange market. The Exchange Banks took advantage of this particular clause while importing sovereigns into this country in November and December, 1928.

Central Bank of Issue, the giving of gold bullion for internal purposes has to be carried out and any attempt to manipulate the assets, liabilities and investments or the bank's reserve should be given up. Every other tendency towards hoarding gold, be it in small or large quantities, should be discouraged.

Internal Remittance Business.

One of the minor aims of Central Banking is to reduce the cost of transfer of money and make it as cheap as possible. The Imperial Bank of India is doing this work to a certain extent and charges differential rates to the public and the banks in this respect. These charges of $\frac{1}{32}$ per cent. on Rs. 10,000 to banks and $\frac{1}{16}$ per cent. per Rs. 10,000 to the public are undoubtedly high and the Central Bank of Issue must not only maintain the differential charge as between the public and the banks but must lower them to $\frac{1}{4}$ of a rupee for sums between Rs. 1,000 to Rs. 10,000 plus actual telegram charges in case of T. T. This charge can be doubled if the public should desire this service from the Central Bank direct.

Other Aspects of Government Business.

Besides looking after the Treasury work of the Government it must undertake the floating of long-term loans and Treasury bills, the repayment of interest on the same and do other lines of monetary business entrusted to it by the Government of India or the Provincial Governments. The Central Bank of Issue must secure a more thorough organisation and concentration of State Reserves and funds than what the Imperial Bank has done.

Relations with other Banks.

Preferential treatment to the Imperial Bank as the sole agent of the Central Bank would not be conducive to the growth of other joint-stock banks. As its competition with other joint-stock banks has become very keen during the course of the past two years any perpetuation of the favourite wife treatment should be discontinued. Other sound banks should be selected to act as agents of the Central



Bank's business. It is this policy alone that can secure adequate banking facilities on cheap and favourable terms.

Clearing House Work.

The Central Bank should organise facilities for clearing business at all places where it has branches. Facilities for inter-provincial and intra-provincial clearing can and should be organised on the Federal Reserve Bank's model. Without such a settling agent with a well-organised clearing system it is impossible to expect a widespread use of cheques in this country.

Agency Business.

Besides working solely in the direction of the wider national interests it is also recognised that the Central Bank should eschew competition with the commercial banks which are required to keep interest-free deposits in its hands. To achieve this it must not only be a marginal lender of funds in the money market, but it should not perform services that compete with those offered by ordinary commercial banks. The Central Bank should not be permitted to encroach on the commercial bank's field as agent for other banks. It can be permitted to act as agent for Central Banks alone. Such a step would raise it to a higher pedestal and invest it with the dignity of a Central Bank and other currency-controlling authorities.

Relations between the Government and the Central Bank.

Whether it be "active control" or "mere supervision" that the Government can exercise over the Central Bank depends on the capitalisation of the Central Bank itself. A state-owned or quasi-state Bank means real control which can after all be abused at any time if the Finance Member is so minded. A stockholder's bank or a privately owned bank gives scope to the Government to exercise supervision and see that public interests are not sacrificed. As note-issuing which is a profitable and valuable concession is to be handed over to the Central Bank, a part of the profits can be ceded to the State. While a privately owned Central Bank, generally in order to

limit the dividend to its shareholders, grants a portion of the profits to the State, it must also be considered a "*quid pro quo*" for the privilege of the note-issue and use of Government deposits which are free of interest. To guard against the dangers of excessive governmental interference it has become usual to enumerate specifically the limited powers of interference which the State can wield over the Central Bank. The right of nominating a few directors to the Central Bank can be retained. The responsible head or Governor of the Central Bank might be nominated by the Government. An official committee with the Finance Minister as its President can exercise supervisory powers over the note-issue and see that the business does not overstep the laws and statutes of the Bank. Something like a continuing audit of the Central Bank's administrative proceedings can be arranged for under the supervision of this official committee. While these are to the public interest it is unnecessary to insist on the subordination of the management of the Central Bank to the Finance Department of the Government.

Bank Balance-sheet.

An up-to-date return showing the assets and liabilities of the two departments of the Central Bank, the Issue and the Banking Department should be regularly published. In advocating the proportional reserve it must be realised that there are difficulties forthcoming in publishing the business of the bank under the head of the two departments. Up till now there is no precedent for a Central Bank of Issue based upon the proportional reserve system placing dual accounts. But as there is no insuperable difficulty in publishing the returns of the two departments separately the method of the separate accounts for the two different departments can be advocated. But we have already seen the practical advantages of amalgamating the two departments and in case this suggestion is adopted a telling balance-sheet has to be issued by the Central Bank. India is a land of anomalies and perhaps India would be the first and only country to exhibit this particular anomaly of a Central Bank issuing notes on the P. R. system and insisting on the logical separation of the two departments of the Central Bank.

Administration and Management of the Central Bank.

When currency, credit and discount policy can be decided by the Central Bank there is no reason why all the members of the Board of Directors, nominated as well as elected, should not be Indian nationals or foreigners by birth but who consider India as the land of their domicile. In the reorganised Reichsbank the Managing Board (Reichsbank's Directorium) consists purely of German officials. It is only in the General Council (Generalrat) that seven foreigners are allowed and the main functions of the Generalrat are (a) to elect subject to the approval of the Reich's President its Chairman, who is also the Chairman of the Managing Board, the President of the Bank and its managing director, (b) to elect the Commissioner for the note-issue by a majority of nine members, six of whom must be foreigners. Apart from such control over the bank as the General Council may exercise through its electoral powers, its functions under the law are advisory, its formal assent not being legally required for any decision of the Managing Board. Thus it is apparent that German nationals alone can control the real policy of the Central Bank.¹

Annual Report.

The Central Bank should publish an annual report containing a clear statement of its operations so as to enable people to realise how far the institution has been satisfactorily working, and the more intelligent observers may make important suggestions for improving the work of the Central Bank.

Co-operation with other Central Banks.

It has already become the accepted practice of the Central Banks to confer with each other and outline their policies with a view to secure the greatest possible economy of gold, for it is feared that the

¹ Kisch however does not seem to realise this point but says that due to peculiar circumstances the General Council must include seven members of foreign nationality. He does not mention and also fails to appreciate the point that even if foreigners are present here the management is not vitally affected; see Kisch, "The Central Banks, p. 60; see the Memorandum of the League of Nations on Currency and Central Banks, Vol. II (1923-24), p. 69.

world's production of gold would be on the decrease and a fall in world prices is inevitable under such a regime of diminished gold production. To prevent long-period fall in world prices ameliorative action would have to be designed by the Central Banks and they would have to be loyally carried out in all countries so that the danger can be averted. It is already apparent that something has been achieved in this direction by almost all countries reducing the amount of gold in circulation and as the credit structure is being perfected in these advanced countries the use of additional gold is discountenanced. The Central Banks are mobilising their gold resources and are actually holding more gold reserves than in the pre-war days. If, after all, the anticipated decrease of world's production of gold were to take place, the Central Banks can and must co-operate with each other and tend to work out the payment of each other's trade balances by means of international securities. The reserve proportion needed can be reduced further and the excess gold liberated to fill up the gap produced by diminished gold production. Propaganda for lessening the industrial use of gold should also be undertaken. Resort to barter to satisfy one another's requirements can also be thought of. At such a time it would be the duty of the Central Bank of this country to carry out loyally the suggestions intended for further economy of gold and readily share the burden of the world's gold standard system in common with the other Central Banks.¹

The Practical Difficulties in the Path of the New Central Bank.

People entertain some doubts as to the practicability of a successful and effective working of a Central Bank in this country. It has indeed, a rough and rugged road to travel before it can overcome the traditional habits of the people. It is quite probable that the best way of starting a Central Bank of Issue is to proceed from below upwards. That is, if there are a large number of joint-stock banks the Central Bank can function smoothly and enlist their support in improving the monetary structure of the society. It is true that there is no bill market where a sufficiency of bills can be secured as cover

¹ For a further discussion of the topic, see the chapter on Banking Management.



for further financial facilities at the hands of the Central Bank. In the absence of such bills accommodation can be granted only on promissory notes under adequate safeguard. A change in the banking habits of the people can be brought about by persistent propaganda work in this direction. Genuine trade bills can be created by banks agreeing to accept bills drawn on them. These bills can be called into existence by the creation of acceptance houses and a discount market. The Multani Bankers and Chettis can do this business of accepting and discounting bills if they are sure of rediscounting facilities with the Central Bank. The money market always develops round the Central Bank. In its attempt to become self-supporting the Central Bank would have to encourage bill-discounting. This is what the Federal Reserve Banks had to do. It is undoubtedly true that India presents greater difficulties. Although these difficulties would be embarrassing and acute they have to be faced and they are by no means insuperable.

Secondly there are not also many indigenous joint-stock Banks. Without a network of banks the Central Bank cannot be a success. It may be considered that the time is not ripe for the Central Bank as a sufficient number of well-developed constituent banks are not in existence. We cannot hope to build a sound banking structure from the top instead of from the bottom. But the experience of other countries refutes this line of reasoning. Even when the banks are few there is no real unified control over the credit situation at present, thus making monetary stability an impossible thing in India. Without the Central Bank as the sheet-anchor of credit, as the custodian of the ultimate banking reserves of the country and as a central rediscounting agency, it is not possible to have well-spread joint-stock banking in the country. The effective control of bank cash lies solely in the hands of the Central Banker. We have already seen how every Central Bank's purchase and every loan by a Central Bank increases the cash reserves of other banks and provides the basis for the creation of bank money. Similarly every sale by a Central Bank or repayment of a Central bank loan reduces bank cash and restricts the supply of money. It is entirely erroneous to consider that it is gold movements that can control the volume of money. The purchase and sale of non-gold assets by a Central Bank can regulate the volume of bank cash or credit money in any society.

The present size of the Imperial Bank may conceivably be a source of danger to the smooth working of the Central Bank. A conflict might develop between the Imperial Bank and the Reserve Bank with all its adverse effects on commerce and industry. During the initial stages, the Imperial Bank can well be a bigger institution than the Reserve Bank, but it cannot maintain the same liquid position as the Central Bank of Issue. It is useful to bear in mind, in this connection, the satisfactory relations between the Bank of England and the Big Five as worthy of imitation in this country. If the Big Five are a useful example to the Imperial Bank the attitude and history of the Standard Bank of South Africa are a significant warning. Its haughty isolation alike from the South African Reserve Bank and the other institutions of the Banking system is to be severely deprecated.

The commercialised Imperial Bank might indeed have much to lose by the establishment of the Central Bank of Issue. It would be palpably unprofitable to maintain some of its non-paying branches and perhaps some of them would have to be closed unless Government assistance in the direction were freely given. There are instances of Central Banks affording special help to particular banking institutions with certain definite ends in view and no outcry can be raised against such provisions as necessarily making for invidious distinctions. The Imperial Bank of Japan lends at 2 per cent., *i.e.*, a low rate of interest, to the Yokohama Specie Bank. If joint-stock banking facilities are to extend in this country, similar help will have to be rendered to all the deserving banks. The Government of India has all along been an invaluable asset to the Imperial Bank. The free lending of its resources, support and backing has given it a unique prestige in the market. Very tangible advantages in the shape of large profits have been reaped. It may be that it is uneconomical in management, that it has only carried out branch extension in letter instead of the spirit, that it is purely non-Indian in management and in outlook and that it has done little in furtherance of our national economy. Whatever its faults may be it must be admitted that it is more or less suicidal to deprive it at this stage of its sole prop, the

¹ This situation has recently been changed. See my articles entitled *Banking Reconstruction*, published in the weekly paper, *Welfare*, Calcutta, Feb. 7, 1929 to May 18, 1929. ©



support of the Government. What India must have is at least an uninterrupted, even if a somewhat slow, extension of commercial banking which can adequately pool together the scattered capital resources of the country. So what we should do is not to oppose the grant of such facilities to the Imperial Bank but to secure the same help for other sound and deserving institutions which offer to undertake this selfsame task of spreading conservative commercial banking in the interior of the country. In the case of the Imperial Bank the grant of special concessions, such as the use of free balances for 20 years, would tend to prejudice the interests of the indigenous banks still further and their welfare and progress are matters of no small concern to the country. It is essential that neither the Imperial Bank nor the indigenous banks should suffer by injudicious distribution of the Central Bank's assistance and patronage. *India requires more and more of these banks to tap the endless small hoards which otherwise can never be transformed into one running stream of active banking capital.* Public support must be given and it would call for some kind of Government control, and at the present state of banking in the country it would be grossly impractical to oppose any reasonable measure of Government supervision over individual banks.

It is well to remember that in the popular tendency to accumulate precious metals the banks have at once a problem and a danger. This habit has to be changed and till it is reduced to safe limits the Bank of Issue has to guard its reserve. It must be steadily borne in on the mind of the people that an investment or a bank deposit is infinitely better than holding bullion. The recommendations of the Hilton-Young Currency Commission in favour of floating some form of gold certificates, calls for early if not immediate adoption. They would easily open to the community the possibility of saving in this form. The provision which requires the Central Bank to buy gold at Rs. 21-3-10 per tola when offered in minimum quantities of 40 tolas might undoubtedly tend to bring out gold hoards in small dribblets. We are not keen on gold circulation and as the British gold sovereigns can be imported at Rs. 13½ to a sovereign, no one would refuse them when tendered in payment of rupee debts, legal tender or notes. Their actual price is quoted in the bullion market every day. They have their sure and undoubted worth as bullion and can be sold to the

Central Bank in lots of 40 tolas as it is bound to take the bullion at Rs. 21-3-10 per tola. The gold bullion standard is admittedly a commodity standard at a fixed price in gold rupees and transactions are confined to lots of 40 tolas or 15 ozs. of fine gold.

Although the Central Bank may be given a free hand to do remittance work and thus steady the external value of the currency, still the reaction on the money and exchange market has to be properly noticed. As sufficient time would be granted to the bank in making the remittance it is the bounden duty of the bank to secure the above remittance without creating undue stringency in the local money market ; for this tends to raise the bank rate and the commercial people pass the strain on to the general public who are thus penalised for the inability of the bank to send remittance satisfactorily from the country.

The mutual conversion of gold into paper and paper into gold is essential for the stability of the currency. Currency ought to expand with every sale and contract with every purchase. Trade bills are automatically self-liquidating instruments of credit and, if on maturity payment is not made, the discounting banks will be liable to the Central Banker. Till now the banks have been encouraging the cash credit system but the disadvantage is that it does not permit the transference of such loans to the Central Bank. Although the policy of extending credit by rediscounting can have adverse effects on rates of sterling exchanges, still there need be no fear of unstable exchange, for local currency can be converted at the Central Bank into the standard price adopted in London when tendered in lots of 40 tolas or 15 ozs. of fine gold for export purposes.

The real meaning of rediscounting is co-operative action and the whole banking structure depends on this essential feature. The defects of the Indian banking system as it is now working, are high bank rates of the Imperial Bank, inelasticity of the Government paper currency except to the amount permitted under the P. C. Act, lack of properly organised facilities for rediscounting eligible bank paper and want of co-ordination and co-operation between the different agents in the money market. The provisions for rediscounting are the real link between the different units and mobility is thus imparted to the reserves of the Bank. It is admitted on all hands that



the Central Bank should extend to the scheduled banks such facilities for rediscounting as can be safely made subject to the provisions of the law ; but at the same time there should be an authority to which an appeal can be made when the scheduled bank feels that the Central Bank has made an unfair decision in its case. The scheduled banks should, in turn, remember the cardinal duty of repaying the borrowings promptly and keep rediscounting as low as possible so as to prevent inflationary tendencies. When there is no limit placed to the rediscounting of the scheduled banks funds can be easily secured and these should be used in discounting short-term paper or lending for short period on cash credit for *bona-fide* trade transactions. The smaller scheduled banks should freely rediscount their eligible paper and promptly liquidate their borrowings at the end of each busy season. A distinct provision for lending accommodation to non-scheduled banks through the scheduled ones would be desirable.

Finally the cash reserve that the Central Bank should be keeping against the note and deposit liabilities must be carefully regulated. The minimum reserve should not become the actual maximum reserve of the Central Bank. If we examine the pre-war practice of the Continental Banks, they were maintaining reserves equal to more than 50 per cent. of their liabilities. The necessity of keeping a high reserve should be understood. It is always wise to be armed with a higher reserve than the minimum prescribed by law in order that sudden demands may be met without serious disturbance of credit. The Central Bank must realise that "the gold standard without gold is worse than Hamlet without the ghost."

Conclusion.

The efficient and successful functioning of the Central Bank of Issue depends on two factors, a Charter with all its provisions carefully laid down, especially those referring to rediscounting and open market operations and secondly the policy to be adopted by the practical administrators of the Bank. It can be said without hesitation that the provisions on the whole should reflect thoughtful and careful work on the part of its framers and embody such rules and customs as have been proved to be wise and wholesome by the experience of the Central Banks of other countries. Provision for a

regional basis of the Central Bank of Issue must be made with due reference to the economic importance of the various parts of the country. In providing for a deficiency in the reserve it should secure liberal conditions which would not hamper heavy rediscounting by the Central Bank. The commercial paper and bills of exchange that can be discounted must be limited to a maturity of ninety days and in this respect the best of the practices of other countries must be followed. Even the character of the bill of exchange eligible for the Central Bank's portfolio should be carefully defined.¹ In the matter of financing agricultural industry the extension of the time limit to nine months is an absolute necessity and need not be regarded with any apprehension or fear. In the Federal Reserve System of the United States of America, agricultural paper maturing within nine months is eligible for rediscounting. The Reichsbank affords an exceptional treatment to agricultural paper and allows one renewal in its case. The Central Bank should be empowered to lend for three months on promissory notes of scheduled banks for holding or trading in securities of the Government of India or a local government, but there should be a limit to the amount of credit that can be extended in this direction and it should also be lent at a slightly higher rate say by $\frac{1}{2}$ per cent. at least, than what the Central Bank would charge on trade and agricultural paper. A slow and steady growth of bank acceptances would tend to create a discount market in the important monetary centres. Power of direct discount of such bills as are eligible for rediscounting must be granted and the open market operations can be conducted judiciously at the initiative of the Board of Directors. This should be freely exercised if interest rates are abnormally high in the market. It should also serve to develop the discount market, to control the movement of gold, to rectify the exchanges and assist in the financing of the foreign trade of the country.

¹ It is unwise to depend on instinctive intuitions of the banker in this matter. A former head of the House of Rothschild always depended on his tongue and remarked that he could discover a genuine trade bill from a finance bill as the salt on the bill would show that it really crossed the sea. Another expert French Banker said that he always depended on his nose to do it for it enabled him to smell of the produce against which it was drawn. While systematising the money market such things cannot be allowed to work satisfactorily.



The raising of the bank rate, the open market operations of the Central Bank and moral suasion are now admitted as the best methods in regulating the credit situation in all countries. Stability in economic life is now the chief criterion and mere credit extension at unduly low rates of discount tends only to increase the amplitude of cyclical fluctuations with alternations of inflated profit and heavy loss. The Central Bank should respect all the established tenets of discount policy. The officials responsible for the working of the Central Banking system should not fail to profit by the lessons of European Central Banking experience. The rediscounting policy should not be merely opportunistic. It is indeed true that the human equation cannot be eliminated in Central Banking. But their efforts to control credit and prices should not be of such a character as to be misunderstood by the people. Although stability of exchange is to be one of the chief objects of the Central Bank still it should not become its sole preoccupation. Nor should it regard itself as merely an agency for supplying emergency currency in the busy season and alleviating crises when they occur. The authorities must keep in mind the broader general economic well-being and progress of the whole country, and fluctuations in bank rate must be guided by changes in the general price level and other data relating to healthy and legitimate trade and industrial production. The essential need of the future is to secure the maintenance of economic progress, with a growing population and ever-improving standard of living, both of which require an expansion in the volume of production and trade. This can only be done by the Central Bank of Issue thoroughly overhauling the technique of our credit and currency system. Judgment, tact, broad economic knowledge, energy and initiative are essential on the part of the executive officers of the Bank and they should be actuated with no other motive than a single-minded devotion to the wider national interests and try to discharge them without sacrificing its well-recognised responsibilities. They must be infinitely wise and infinitely virtuous at the same time. They must pay heed to tradition, precedent and authority and act as a steadying and stabilising influence on the banking community of the country and its general financial and industrial mechanism.

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CHAPTER IV

THE EXCHANGE BANKS.

The official definition Two groups of Exchange Banks Statistical Tables relating to business Explanation of their exchange business The nature of their business in India Foreign exchange explained Their defects Quotation of Exchange Rates Their service to India Their vested interests Can Indian commercial banks undertake exchange business Suggestions to overcome their difficulties Their future position.

The Official Definition.

The official definition of the "Exchange Banks" points out that the head office of the bank should be outside India. But in Western countries this word is used as "a general term to include those banks that are specially concerned with financing the trade of India and China which countries not having a gold standard have exchanges peculiarly liable to fluctuation."¹ The fact that the Presidency Banks were not allowed to deal in foreign exchange business gave scope for these banks to specialise in it.² No rigid partition of business exists between the three major types of banks doing business in India, viz., the Imperial Bank, the Exchange Banks and the Indian Joint-stock Banks. The Exchange Banks besides dealing in foreign exchange conduct ordinary banking business, i.e., they lend money

¹ See Dr. L. M. Minty, "English Banking Methods," pp. 44 and 45.

² Although Cooke, Brunyate and Symes Scott point out that this limitation was a self-imposed one on the part of the Presidency Bank of Bengal and the later researches of this period have faithfully copied this information, still the name of the director who imposed this limitation is not given out in any book on this subject as yet. It was Mr. Cockerell who unconsciously added the words "payable in India," etc., and thus imposed this limitation. See the Asiatic Journal which quotes it from the Bengal Courier, June 12, 1838.



at call, make investments, grant loans, issue commercial and traveller's letters of credit, receive deposits and do agency business, but during the busy season they invest a considerable portion of their funds in discounting foreign trade bills. It is this special feature that differentiates the Exchange banks from the other banking institutions of their country. The financing of the foreign trade of India is practically in their hands.

Two Groups of Exchange Banks.

The Exchange Banks fall into two groups, *viz.*, Group I: Banks whose business in India is limited and forms say one-tenth of the total volume of their business. The following banks belong to this category :—

Name of the Bank.	Head Office.	Year of establishment in India.
1. The Comptoir National D'Es-compte de Paris ...	Paris	1862.
2. The Yokohama Specie Bank, Limited ...	Tokio	¹
3. The Sumitomo Bank ...	Osaka (Japan)	Bombay, Dec, 1916.
4. The Bank of Taiwan, Ltd. ² ...	Taipeh (Formosa)	Bombay, 1917, Calcutta, 1921.
5. The Mitsui Bank, Ltd. ...	Tokio	Bombay, 1924.
6. The Kanan Bank, Ltd. ...	Tokio	Rangoon.
7. The International Banking Corporation ³ ...	New York	1903.

¹ The branches in India of the Yokohama Specie Bank were opened at Bombay in December, 1894, at Calcutta in October, 1911, at Rangoon in January, 1918, and at Karachi in July, 1925.

² The Bank of Taiwan was temporarily closed in the spring of 1927 as it locked up its money in advances to the Suzuki concern. The Japanese Government authorised the Bank of Japan to grant advances to the Bank of Taiwan and from May 9, 1927, it began conducting business as usual. A full statement of the events which has been kindly furnished to me by the Consulate General of Japan is enclosed in Appendix III.

³ This bank is the offshoot of the National City Bank of New York and though it began conducting business in India in 1903, this name was adopted in 1927. It has branches in Bombay, Calcutta and Rangoon.

Name of the Bank.	Head Office.	Year of establishment in India.
8. Nederlandsch Indische Handelsbank ¹ (Nederlands India Commercial Bank)	Holland	1863
9. Nederlandsche Handel Maatschappij ²	Holland	1889 Rangoon. 1920 { Bombay. Calcutta.
10. Hongkong-Shanghai Banking Corporation ³	Hongkong	1867.
11. American Express Company ...	New York	
12. Banco National Ultramarino ...	Lisbon	Bombay.
13. The Imperial Bank of Persia ...	Tehran	Bombay.
14. Lloyd's Bank. Amalgamated with Cox & Co. and H. S. King & Co. ⁴	London	1923.
15. Thomas Cook and Son (Bankers)	London	
16. The National Bank of South Africa	Cape Town	Bombay.

The Russo-Asiatic Bank and the Deutsche Asiatische Bank have closed their doors since the outbreak of the last war. Besides the three Japanese Banks which are generally mentioned by the other writers on banking, there are two more Japanese Banks having

¹ This was started in 1863 as a private bank and began extensive plantation business in Java and the Dutch East Indies. In 1884 it had to shed its plantation business and due to prompt help from the Nederlands Trading Society it did not fail. See E. Labarre's Abridged English Edition of the History of the Nederlands Trading Society, published in 1924, pp. 48, 50.

² The Nederlands Trading Society was formed by King William I in 1824 with the object of promoting national trade, shipping, fisheries, agriculture, factories and transport and open up new avenues for Dutch commerce. It soon became the banker to the Government. By 1874 it began to combine banking business with trade in goods. From 1890 it began conducting increasing volume of exchange and banking business in the East Indies. In 1889 the first Indian Office was opened at Rangoon and it was confined to local credit business. In 1920 branches were opened at Calcutta and Bombay. From a mere trading concern it became a successful banking corporation in the widest sense of the term. The most distinguishing features of the concern were its many-sided activities in the direction of plantations and forming syndicates for constructing railways. See *ibid*.

³ It has an important Office and Committee in London.

⁴ This amalgamation was brought about in 1923.

branches in India. The Mitsui Bank has a branch at Bombay opened in 1924, and the Kanan Bank has a branch at Rangoon.

Passing on to Group II the Exchange Banks that belong to this category are the following. Though their head office is situated outside India, they have their major portion of business conducted mainly in India.

Name of the Bank.	Head Office.	Year of establishment.
1. The Chartered Bank of India, Australia and China ¹	London ...	1853
2. The National Bank of India, Ltd. ²	London ...	1863
3. The Mercantile Bank of India, Ltd.	London ...	1892
4. The Eastern Bank of India, Ltd.	London ...	1909
5. The P. and O. Banking Corporation. ³	London ...	1920

¹ This bank does no business in Australia. Owing to the hostility of the Press in Sydney, it had to give up its attempts of opening an Office in Australia. It is not difficult to divine the reason. In October 1927 it secured control over the P. and O. Banking Corporation as 51 per cent. of the shareholders sold their shares to the Chartered Bank of India and from January 1928 this bank merger is conducting its business.

² It transacts a large volume of business in South Africa and British East Africa.

³ In 1921 the P. and O. Banking Corporation affiliated itself with the Allahabad Bank and owing to the recent merger of the Chartered Bank with the P. and O. Banking Corporation, the affiliated banking combination would have about 89 branches in all. While speaking of this transaction it is essential to know the nature and object of this fusion. "About 196,059 shares in the P. and O. Banking Corporation were acquired so as to secure a controlling interest in the P. and O. Bank. We regain control of valuable business connexions which had rather passed away when the P. and O. Bank came into existence, such business covering India, Burma, Ceylon, China and Japan, and we prevent the business from getting into other hands. Further we have a well-established business working in harmony with ourselves and ceasing to function as active opponents. To make effective our control of the Bank Mr. W. E. Preston has become the Vice-Chairman of the P. and O. Bank and Messrs. Bateson, Colin Campbell and Mackay have joined the Board of Directorate of the P. and O. Bank." See the Chairman's speech on the 74th ordinary general meeting of the Chartered Bank. This practice of large banks affiliating other banks to themselves by the purchase of shares is not common in Indian banking circles. This practice arose during the war and in the London money market there are several big joint-stock banks holding the shares of smaller ones conducting business in Scotland and Ireland.

The newly started Imperial Bank of India does exchange business for its customers only. The Alliance Bank of Simla ¹ and the Tata Industrial Bank ² did exchange business on a large scale. One or two Indian Banks ³ have recently been started in Bombay to deal with exchange business. Both the foreign firms, Thomas Cook and Sons and Grindlay and Co. ⁴ conduct exchange banking on a large scale but it is ancillary to other work they undertake. There are several other houses which conduct semi-banking business and their establishments in London as well as in India give them an opportunity to conduct exchange banking on a small scale. Some of the 'interior' joint-stock banks have correspondents in London and other financial centres of the world. Sometimes they do exchange business on their own account but very generally they keep only working balances to supply exchange facilities for their customers. They buy and sell and receive for collection drafts and telegraphic transfers, grant commercial credits, buy approved outward bills, issue travellers' letters of credit available in all places of the world.

*Statistical Table relating to their Banking Business.*⁵

£ 1,000 omitted.

	No. of Banks.	Paid-up Capital.	Reserve.	DEPOSITS.		In India.	CASH BALANCE
				In India.	Out of India.		Out of India.
				Rs.	Rs.	Rs.	Rs.
Group I	14	64,586	53,689	199,714	847,957	29,189	110,407
Group II	5	9,644	10,392	505,743	75,604	64,972.	11,351

¹ The Alliance Bank of Simla failed in 1923.

² The Tata Industrial Bank, recently amalgamated with the Central Bank of India.

³ The Union Bank of Bombay and the Industrial and Exchange Bank. Of these the first bank is now under the management of the Central Bank of India and in the near future there may be a complete amalgamation. The Industrial and Exchange Bank has suspended payment.

⁴ Messrs. Grindlay and Co. is affiliated to the National Provincial Bank—one of the "Big five" of the London Joint-Stock Banks.

⁵ This table relates to the business of the Exchange Banks during 1925. The banks in Group I are 13 and figures relating to the National Bank of South Africa are not included. See the 12th Issue of Statistical Tables relating to Banks in India, p. 15.

Explanation of their Exchange Business.

The position of the Exchange Banks in our banking system is essentially two-sided. On the one hand they perform their business in India and on the other they conduct banking business in the country of their origin. The eastern Exchange Banks pay a slightly higher rate for deposits than what the London Joint-stock banks pay. Their usual deposit rate however is two per cent. on current accounts provided they do not fall below a stipulated minimum. In India they pay a slightly lower rate than that of the Indian Joint-stock banks but their rates are more favourable than the Imperial Bank rate for deposits. The Imperial Bank does not pay on current accounts while the Exchange Banks pay 2 per cent. on balances exceeding a definite limit. For fixed deposits they pay a higher rate than the Imperial Bank.

Formerly they used to take pride in the fact that they obtained capital for India from London but now they have discovered that money can be tapped in India also. J. M. Keynes pointed out long ago that these Exchange Banks never kept an appreciable cash reserve in India but their position has been much strengthened ever since that time. But of late it has again fallen to a low figure as denoted in the following table.

Percentage of cash to liabilities on 31st Dec. each year :¹

Exchange Banks.

		1916	1920	1921	1922	1923	1924	1925
Group I	(Agencies of large banks doing business in India).	35	58	43	33	27	31	15
Group II	(Banks doing considerable business in India).	25	30	28	19	19	20	13

The chief difficulty of the Exchange Banks consists in their undertaking to perform their business in several places. They have to so carefully adjust their resources that they do not suffer from want of capital at any place and this is no easy task. Their position would be very difficult if a concurrent crisis

both in the London money market and in India were to develop simultaneously. Normally they depend on importing funds from London to India and remit it back after the period of employment. So long as they have sterling assets to cover their liabilities in other currencies there is no danger. A sterling bill can easily be sold in the highly organized discount market of London and the proceeds are always equal to gold in a free gold market as London. So long as sterling is convertible into gold, it has to be considered as a safe cover for a liability in any other gold standard currency. Danger arises only when the sterling is not convertible into gold and at such period the Exchange Banks should cover every obligation with an asset payable in the same place and in the same currency.

The Nature of their Other Business.

The Exchange Banks besides dealing in foreign exchange, and buying export and import bills conduct ordinary banking business competing to a certain extent with the Imperial Bank and the Indian Joint-stock banks in the matter of loans and overdrafts. They finance internal trade in certain big centres of trade like Amritsar, Srinagar and Mandalay. The piece-goods trade in Delhi and Amritsar and the leather trade of Cawnpore are financed to a great extent by them. They compete with the Bengal branch of the Imperial Bank of India in the matter of financing Jute operations. In the Madras Presidency they confine their business solely to the financing of export and import business but they practically do very little or hardly any local business for Indians. The Exchange banks utilise the Marwari bankers to a great extent and grant advances to them on security of goods, produce or bills of exchange and fix exchange contracts with them from time to time. The Marwari banker considers it as his main duty to secure advances from the Exchange Banks and these finance the exports and imports to and from the interior of the country to the ports. The Exchange Banks have about sixty-two branches in the interior of the country and there is no statutory restriction compelling them to keep a high proportion of cash reserves against their liabilities. They deposit a part of their cash reserves in the Imperial Bank of India. They are some of the chief importers



of gold bullion and sovereigns into the country. The gold bars of the two banks, viz., the Chartered Bank and the National Bank of India are the most popular. Their colour and touch are well-known and though the Central Bank of India is trying to import gold bars of 5 and 10 tolas each, these have not succeeded in undermining the popularity of the above gold bars.¹ Silver is also imported on a large scale by the Anglo-Eastern Banks.²

Coming to their exchange business the export bills are classified as D/A (documents on acceptance) and D/P (documents on payment). They are bought in India by the branches of the Exchange Banks and are negotiated in India and drawn on London and as they are drawn on well-known houses in London they can be discounted easily. The head office of the Bank in London holds the D/P bills till maturity and cashes them. The D/A bills are rediscounted immediately after acceptance at the London Joint-stock Banks or bill brokers or the Bank of England according to the ease or tightness of the money market in London. A large majority of the export bills in Calcutta are sight bills and received by the banks in time to be despatched home by the weekly mail. Some of the export bills are usually drawn for three months. They are either 'clean' or 'documentary.' Whether the D/A bills will be immediately rediscounted or not depends on three factors: the nature of the drawer of the bill, the Bank of England's rate of discount and the bank's own need for cash. The money to finance the export trade thus secured by means of rediscounting export bills is British capital and not Indian money.³ This is considered a danger to our export trade.

¹ The gold bars that are specially for use in India and the Far East are manufactured in London in quantities of (10 oz., and 100 oz., etc.) and the gold bars sold by the Bank of England are packed for export, free of charge, but the cost of the box, including the packing is usually about 4s. Each bar weighs 400 oz. and it is roughly worth about or a little over £1,700.

² The Bombay importer known as the *chokey* agrees to pay the price to the Exchange Bank on the arrival of silver and through the medium of shroffs this silver is distributed to the up-country centres. In addition to these the Marwari broker-speculators are also active dealers in the silver market. The Bombay Silver Merchants' Association regulates the market. For detailed information see B. White, "Silver, its History and Romance."

³ No accurate statistical information has been collected with the object of estimating the amount of funds employed in rediscounting the Indian Trade Bills. Some idea can be had if the amount of bills rediscounted by the Exchange banks belonging to Group II,

As the Indian deposits of these Exchange Banks increase this danger will be minimised. India's dependence on external capital is being slowly reduced and if the export surplus is wisely invested or banked in the country reliance on external capital would not be necessary. During the last 15 years there was a great development of the capital resources of the country and the Government during the last three years were able to finance large sterling expenditure on capital account apart from revenue account and paid small repayments of sterling liabilities and the English stock-holders of the G. I. P. Ry. were paid off to the extent of two or three million sterling. Thus absolute reliance on external capital is no longer a feature of the present-day economic conditions as it used to be in the past. Again the Central Bank that would be started in the country would absorb much of the rediscount business in future; hence it would be Indian money that would finance our trade. At present there is no difficulty in financing export bills and the Exchange Banks usually arrange adequate finance. Previously when the import cover was insufficient, they used to generally depend on Council Bills for laying down funds in India. Even now no emergency currency is actually needed for this purpose of financing export bills.

The import bills are negotiated in London and drawn on India. Again it is the Exchange Bank that finances the import trade through their London office and its funds there. The bulk of the bills are drawn D/P (documents on payment) in sterling. These bills are never rediscounted. These can be repaid at any time during their currency. A large number of them become past due as the importers treat the due date of maturity with indifference. The result is that the payment for the bills is uncertain. The Exchange Banks finance the exports of British shippers by discounting their documentary bills of exchange and the shippers execute letters of request and hypothecation in favour of the Exchange Bank. The Exchange Banks become holders for value of bills drawn on the Indian consignees. The Indian consignees generally accept the bill and apply to the Exchange Banks for delivery of goods before payment against trust receipts. The bills of lading and other necessary

is taken into account. It is true that they discount other countries' trade bills also but the Indian trade bills form the major portion of their "bills discounted" item.

documents are released. The Indian consignee thus obtains possession of the goods which he holds as the trustee on behalf of the Exchange Bank. The goods are now stored in godowns rented by the consignee and the bonded ware-houses are often selected for this purpose. On selling the goods the consignee would be in a position to pay the bill.

India has a favourable balance of trade which has to be paid to her and the Exchange Banks formerly used to liquidate the balance by buying Council Bills and Telegraphic Transfers.¹ They also sent gold bullion, coin and silver bullion. Besides these there was the transfer of Government Rupee paper from London to India. At present there is the sale of drafts required for Indian travellers and students in England. Thus the purchase of export bills is done with the aid of (1) import bills, (2) sale of sterling to the Government of India payable in London, (3) gold and silver bullion, (4) transfer of Rupee paper, and (5) sale of drafts and telegraphic transfers payable in London and elsewhere out of India to private customers.²

The Exchange Banks are doing quite a lucrative business and the Eastern Exchange Banks so far as their dividend is concerned and the high value of their shares on the stock exchange³ indicates are thriving concerns and thanks to the Gold Exchange Standard system, the speculative element in their business has been removed and a satisfactory 'par of exchange' is established between the silver-using countries and the gold standard ones. They have passed through a keen struggle for existence. They have obtained great reputation consequent to their long establishment in this country and they are very jealous of intruders who may encroach on their business. It is the prevailing opinion that it is practically impossible to start a new exchange bank in teeth of the opposition of the old ones. In 1870 there were only *three* Exchange Banks and in spite of the open-door policy maintained by the Government of India their number is exceedingly small. In 1919-21 about six Exchange Banks opened their business in India and their total number rose to 17.

¹ The new system of Government purchases of sterling by public tender in India has displaced the old one of sale of Council Bills.

² See the 2nd table attached to this Chapter.

³ See the 3rd table attached to this Chapter.

The number now is 18. The nature of the business is such that the customers flock to the old Exchange Banks rather than patronise the new ones.¹ As Wolfe observes, "the English Banks have subdivided the export field in business—like fashion, honeycombing each section with branches, agencies and correspondents and through the undisputed position which London has as the centre of financial transactions in international business are very well placed to serve their clients and English export trade cannot help but derive the utmost advantage therefrom."²

Foreign Exchange Explained.

Foreign exchange business involves two sets of transactions. Firstly, it confines itself to the buying of exporters' bills of exchange drawn on the different markets of the world and the forwarding of these bills for acceptance and discount or for collection to their foreign correspondents or branches, if they exist. By this method the Exchange Banks create credits in foreign centres where the bills are payable. Secondly, these funds have to be utilised and so demand drafts against these credits are sold to those people who have to make remittances. Profits from this business accrue out of a combination of purchase and sale of such credits and the margin between his buying rate and selling rate constitutes his profits. The creation of excessive foreign credits which cannot be used means idle funds in a foreign place. If no sufficient foreign balance is to be had when the demand for banker's bills is brisk, the opportunity for making profits is lost. Success in foreign exchange work depends on the buying of commercial bills just sufficient to meet his own drafts against the same centre. This business principle is often styled in banking parlance as the "rule of compensating purchase and sales," i. e., maintaining an equilibrium between the addition to and subtraction from his foreign balance.

While the above principle affords the theoretical basis on which foreign exchange business is to be conducted there are occasions which

¹ J. M. Keynes says, "Indian Exchange Banking is no business for speculative or enterprising outsiders and the large profits which it earns are protected by established and not easily assailable advantages."

² A. J. Wolfe, "Foreign Credit."

tend to make them deviate from the principle. In case of speculation in foreign bills and investments in foreign bills, there is a sacrifice of principle of purchase and sale.¹ But when he is acting for the buyer or seller of bills of exchange the banker does not forget this cardinal principle.

Broadly speaking it is not the trade factor alone that is the sole force operating on the exchange market. There are other forces working on the exchange market and if a final statement of these different forces is to be made, this tabular form would be of much significance.

Debits to Indian Exchange Banks.	Credits to Indian Exchange Banks.
(1) Merchandise Imports.	(1) Exports (Merchandise).
(2) Indian tourists', students', etc., remittances.	(2) Re-export of precious metals from India.
(3) Immigrant or banker and insurance Co.'s remittance.	(3) Missionaries, Travellers, etc., and their payments to India.
(4) Indian securities repurchased.	(4) Short-term loans floated by Indian business firms or the bankers.
(5) Gold and precious metals imported to this country.	

The supply of bills in the Indian exchange market arises out of exportation of goods, out of the sale of Indian securities to foreign investors and out of payment of interest, etc., on foreign securities owned by the Indian people and short-term loans floated by Indian business firms, the Government or the bankers. These create credits in London and other foreign centres for the Indian Bankers.

Against the credits thus accumulated the bankers sell drafts to those who make a demand for them. Demand for bank drafts arises out of the importation of foreign goods, the services of bankers, etc., payment of interest, etc., by Indian borrowers to foreign investors, expenditure by Indian Government, tourists, students, etc., and repayment of short-term loans floated by Indian borrowers in London and foreign centres.

¹ If it is expected that sterling would rise in the future the exchange banker may buy more sterling futures than he sells, i. e., he overbuys. Similarly if he has reason to expect that sterling would fall in the near future he sells more sterling futures than he buys, i. e., he oversells.

Thus the Exchange Banks receive all payments due to the Indian people by foreigners by taking up the bills of the Indian creditors and advance money on the same or transfer it for collection. The Exchange Banks make payments to our creditors by receiving our money and give us a bill payable abroad or present to us a bill drawn by the English or foreign seller. As our trade does not usually nicely balance, sales and purchases are never equal or in equilibrium. It is the duty of the Exchange Banks to act as the middlemen reducing international trade to barter. ✓

The expression 'rate of exchange' means the terms upon which the bill payable in foreign money will be exchanged for rupees. There is no single rate to cover all varieties of bills drawn in foreign money. Due to variations in risk they command different prices. The rate of exchange refers to bankers' telegraphic transfers drawn upon the foreign country, *i.e.*, it represents the drawing rate for telegraphic transfers on foreign city. The price of the bank bill depends on the intrinsic worth of the foreign coin *versus* the intrinsic worth of the domestic and the usefulness of funds in a foreign city *versus* the usefulness of funds at home. The rates are controlled by the forces of demand and supply of bills of exchange fluctuating in normal times within the narrow range fixed above and below the par by the cost of exporting and importing specie. The duty of the exchange broker is to multiply and perfect his means of gathering information regarding the sources of supply and demand so as to be able to predict what the behaviour of the rates will be. Their tentative bids and offers of the exchange are approximations to the ideal rates at which demand and supply will be in equilibrium. The progress of the rupee rate is generally subject to the influence of several factors the most important of which are the following. The increasing progress of the export trade, the firm monetary conditions of London, the paucity of imports and other means of remittance from India to London and the reluctance on the part of the Treasury to make substantial purchases of sterling, tend to raise the rupee rate upward.

If the rupee becomes more valuable in sterling, it means that the sterling demand for the rupee is strong. Sometimes a present demand for the sterling is accompanied by sale of sterling for one or two or three months ahead. This means that some one having bought already sterling forward to cover his future needs, has found it

advisable to resell the same before the time comes for them to be delivered and to buy on the spot. This can only be done if the "spot price" were low and the future high. But the very fact that people are induced to buy "spot" when low and sell future when high tends to stabilise prices or rates of exchange. The lack of stable standard of payment renders necessary this provision of forward exchange.

Defects.

The Exchange Banks have never perfected the means of remitting the balance of account into this country. The Government by the sale of Council bills and reverse councils have been "spoon-feeding" them at both ends with the consequent result that credit organisation has not been perfected in India. Sir Stanley Reed repeats the charge very eloquently before the Hilton-Young Commission—"I hold the view rightly or wrongly, that this practice of spoon-feeding the exchange banks has been demoralising to the exchange banks and has been used for the organisation of credit. I think if the Exchange Banks, instead of being able to sit down and draw their remittances at convenience on tap, by putting the cup under the tap and taking what they wanted, had been forced to consider ways and means of dealing with this remittance business, they might have gone much more actively into the Indian money market for the development of the Indian resources or possibly—which was a point which was put before one of the earlier commissions—very strongly encouraged the purchase of sterling securities or securities abroad. *In all these ways the Exchange Banks could have been more valuable to Indian finance and the development of Indian resources than they have been quite apart from the exchange operations themselves.*"¹ India could easily have been made a creditor country under their guidance. The purchase of international investments out of the available funds arising out of favourable balance of merchandise payments after paying all visible as well as invisible debits, could have been taught to the people. Even now it is not too late if they undertake to teach the people the art of investing the annually net favourable balance of accounts. Sir Dadiba Dalal wrote long ago that we

¹ Vol. V, p. 246.

missed this favourable opportunity of acquiring foreign investments during the period of the late war.¹

The Exchange Banks always protested against the proposal that the Presidency Banks should be allowed to do exchange business and gain access to the London money market. Undoubtedly this was one of the main causes for dwarfing the stature of the old Presidency Banks. They were against the closing of the mints in 1892. They were against the formation of a Central Bank for India and viewed with jealousy the proposals for amalgamating the old Presidency Banks or the starting of a State Bank. They have unfortunately reproduced the same unscientific method of quoting exchange rates as in the case of the London money market.

Quotations of Exchange Rates.

There are two methods employed in our daily quotation of exchange rates. The first method is to state rupees in terms of foreign currency as in the case of New York, Hongkong, Shanghai, Singapore and Japan. Here the number of rupees against the hundred units of foreign currency is stated. According to the other method of quotation foreign currency is quoted in terms of rupees. Here there are some anomalies. In some cases as in London and Melbourne exchange rates the amount shown is equivalent to one rupee. In the case of France and Germany the exchange rates relate to the amount of foreign currency against hundred rupees.

Exchange Rates ² on 30th June, 1929	... 1s. 5 $\frac{1}{8}$ d.
Telegraphic Transfer ³ on demand	... 1s. 5 $\frac{3}{4}$ d.

¹ See his minority report — Babington Smith Committee. See also the oral evidence of Manu Subedar before the Babington Smith Committee.

² The B/C rate is the rate for retiring bills, i.e., paying them before due date, and is known as the Bills for collection rate fixed daily by the Associated Exchange Bank. Their rate holds good when the acceptors of bills neglect to settle exchange with the banks.

³ This is the sole basis of the Exchange operations and the other quotations for demand and usance bills are based on the telegraphic transfer rates.

	<i>s</i>	<i>d</i>
	Banks selling O/D.	Banks buying 30 D/St.
France (francs per Rs. 100)	... 910	... ..
America (Rupees per \$100)	... 277½	... ..
Hongkong (Rupees per \$100)	... 136	... 138
Shanghai (Rupees per taels 100)...	165	... 155
Singapore (Rupees per \$100)	... 156¾	... 153¾
Japan (Rupees per yen 100)	... 122	... 119½
Java (guilders per Rupees 100)	... 89½	... 92½

As there is a difference in the method of quotations such general expressions as "buy high" and "sell low" and "a falling exchange acts as a stimulus to export trade" are to be cautiously interpreted, carefully noting the method of quotation employed.

It is high time to reduce these quotations to a uniform standard as America has done. Minty writes that "exchange rates were formerly quoted in America as they are still in England, some for so many dollars to the foreign unit and others for so many foreign units to the dollar. It has now become the universal practice to quote exchange rates so many cents to the foreign unit or if a finer quotation is required so many dollars and cents to the hundred foreign units." ¹

Their Service to India.

In spite of these apparent defects on their part, they have done yeoman's service to our country in popularising banking business in our country. Though in the beginning of their career they could not attract huge deposits in India, of late a change has come over the situation. During the last few years their deposits have increased considerably. The floating balances that could have been of some use to trade or industry are placed in their hands and this tends to aggravate the stringency of the money market in the busy season. The following table shows the deposits attracted in India.²

(In lakhs of Rs.)					
Year	Amount	Year	Amount	Year	Amount
1895	1,030	1915	3,354	1922	7,338
1900	1,050	1918	6,185	1923	6,844
1905	1,704	1919	7,485	1924	7,063
1910	2,479	1920	7,480	1925	7,054
		1921	7,519		

¹ Vide L. M. Minty, "American Banking Methods," p. 302.

² Statistical Tables relating to Banks in India, 12th Issue.

So long as these Exchange Banks are worked by the foreigners (both in the directorate and the staff), they cannot cultivate sympathetic relations with the Indian customers. There is a vast and unlimited scope for the Indian Joint-Stock Banks to take up the financing of inland trade, and the foreign banks can never wholly succeed in monopolising this kind of business as they have done in the field of foreign trade.

The Eastern Exchange Banks have started an Association in London. In Bombay, Calcutta, Karachi and Rangoon there are associations of these Exchange Banks in order to protect their common interests. Admission to the Clearing Houses in India was supposed to be solely permitted at the discretion of this Association and it was stated sometimes back that they unjustly refused access to the Indian Joint-Stock Banks to the Clearing Houses. The exclusion of the Punjab National Bank for a long time from the Calcutta Clearing House was considered a legitimate grievance. But no one member bank exerts greater influence than another in the matter of admission to the Clearing House.

During the war period in spite of a rising exchange and their limited financial resources, "they heartily co-operated with the Government in the matter of financing the essential exports required for the war purposes and the market rate of exchange was maintained near the rate at which Council Drafts were sold."¹ Encouraged by the Secretary of State's promise they bought export bills far in excess of purchases of exchange in the other direction.²

When the price of silver began to rise the sale of Council Drafts could not be made at the old rate without loss to the Government. Any undervaluing of the rupee might tend to make it disappear and so the exchange value of the rupee was made to follow the price of silver. From 28th August, 1917, the rates were charged as follows.³

¹ *Vide* Sir H. B. Smith Committee's Report.

² "The Secretary of State assured them against the risk of a rise in exchange by undertaking to sell to them within a year after the War Exchange up to the amount of their overbuying at the rate at which their excess purchases had been made." *Ibid.*

Date of Introduction.	Minimum rate for immediate T. T.	Date of Introduction.	Minimum rate for immediate T. T.
	s. d.		s. d.
3rd Jany., 1917	1 4½	15th Sept., 1919	2 0
28th Aug., 1917	1 5	2nd Nov., 1919	2 2
12th April, 1918	1 6	12th Dec., 1919	2 4
13th May, 1919	1 8	2nd Feb., 1920 (2s. gold)	2 8½
12th Aug., 1919	1 10		(Sterling)

The short-lived attempt on the part of the Government to maintain the official rate of exchange at 2s. (gold) led to further disorganisation of the exchange situation.¹

Such rapid fluctuations in the exchange value of the rupee made the Exchange Banks rather cautious in their "forward operations" of exchange. As Keynes says, "a forward contract is for the conclusion of a 'spot' transaction in exchanges at a later date fixed on the basis of the 'spot' rate prevailing at the original date. Pending the date of maturity of the forward contract no cash need pass (a security as proof of ability to complete the contract is generally taken by the Exchange Banks) and he is protected from the consequences of any fluctuations in the exchanges in the meantime."² By this method of dealing, the importer merchants and the exporters try to eliminate their risks as they are ignorant of the intricacies of exchange. The exchange banker while undertaking to bear these risks due to fluctuations in exchange protects himself, by "setting off" or "hedging" one operation against the other. He 'covers' himself by setting off a sale by a purchase or *vice versa*.

While it is the duty of the Exchange Banker to buy as many export bills as are offered and protect himself as best as he can, our Exchange Banks as soon as they find the free market in exchange breaking down would insist on the providing of full 'cover' for their purchases of export bills on the ground that it would otherwise force them to pile up a big over-bought situation. The whole of the funds would be accumulated in London with very little chance of getting them back to India. The Exchange Banks then refuse to operate except against 'doubles.' They sell remittances only against bills. Such measures generally cause inconvenience to export trade. This unfortunate situation can only be remedied if a Central Bank of Issue were to actively buy and sell foreign exchange as soon as the market rates threaten to get outside the specie points. Stabilisation of exchange within the specie points can be secured by the Central Bank entering into the exchange market on the supply or demand side as conditions require. Next it is always possible to

¹ For a detailed account of the Indian exchange situation in the year 1920, the readers should consult the author's article in the "Calcutta Review" for Feby., 1922.

² J. M. Keynes, "Tract on Monetary Reforms," p. 116.

mitigate the evil consequences of exchange fluctuations by organising facilities for forward exchange. Even in a managed paper currency, as sponsored by the English economist J. M. Keynes, sudden fluctuations of exchange rates can be remedied by allowing gold to settle the international balance of payments. Excessive short-time fluctuations of the exchange rates are to be prevented by the Central Bank having a buying and selling price of gold. This range of gold prices would stabilise exchange rates within limits similar to those set by the specie points in the gold standard system. As the object of the managed paper currency system is constant and stable internal level of prices, this ideal would not be sacrificed if the world price-level were to fall. The exchange rate would be allowed to rise in proportion to the new discrepancy between internal and world prices. The Central Bank would then introduce a new buying and selling price of gold which would closely correspond with the new level of exchange rates. It is the excessive short-time fluctuations of exchange rates that cause disturbance to trade and these are eliminated under the scheme of Mr. Keynes. He would permit relatively permanent movements of exchange rates.¹

In India up till 1893 when the mints were closed for the coinage of silver, the Exchange Banks used to buy and sell forward exchange freely. Their charges for this service varied from week to week and depended entirely on the London discount rates and the merchant's own estimation of the risk. The Government of India have recently fixed the domestic rupee at 1s. 6d. or a fixed weight of gold. This fixed ratio to the foreign unit is to be maintained so that the value of domestic currency conforms closely to the value of the gold or foreign unit. Like the recent operations of the Reichsbank which is permitted to redeem at discretion in gold bullion or gold exchange, the Government of India can likewise convert the domestic currency into gold bullion or gold exchange. Under this effective gold exchange standard system where sufficient reserve is held in London, there is a free market for the merchants in exchange and they would not naturally go in for these forward contracts. It has already been stated that it is the lack of stable standard of payments that renders necessary the

¹ See J. M. Keynes, "Tract on Monetary Reform," p. 190 *et seq.*

provision of foreign exchange. Being an agricultural country India has seasonal exports and during this time the Exchange Banks' purchase of export bills would be greater and it would be difficult to "marry" the forward purchases with forward sales. The sterling balances would be increased and as soon as their export season is over this position is reversed. The Exchange Banks sometimes transfer funds to the Indian money market to lend them at a favourable rate. Suppose that a nine to ten per cent. rate is prevailing in the Indian money market during the busy season while only a three per cent. rate can be obtained on the use of funds in the London Money Market. The Exchange banker sells his sterling resources to the importers and covers this by a forward purchase to be taken up three months hence by the exporters. The operation is known as the Budlee operation. Even granting that no direct profit has been obtained in exchange, the banker obtains the use of money in India at a favourable rate. When there is a superfluity of local resources, the Indian Exchange Banks make similar operations in which a ready purchase may be covered by a forward sale. Broadly speaking the practice of covering exchange forward is always advisable for the merchant. Even in times of peace merchants should cover their dealings in the export trade three to six months forward and in the import trade perhaps a year or more. It is sound business to cover all exchange risks with the banks. Otherwise it would be introducing an undesirable element of speculation.

The Exchange Banks are few in number and with their close-knit organisation they succeed in obtaining more than competitive profits. It is true that Indian export business is seasonal and the trade is always of a fluctuating character. Hence the rates of commission the Exchange Banks charge for their service ought to be higher than what other countries' banks make but they charge a much higher rate. It is also true that the Government's position as a debtor in terms of sterling and collection of revenue in rupees and its attempt to keep prices steady in the latter currency enables the Exchange Banks to take advantage of the situation.

It has already been stated that when exchange fluctuates the Exchange Banks sell low in order to protect themselves. Taking the Paris rate of March, 1924 which was 740 francs, it can be proved that they were selling low as it was then subject to fluctuations.

By the chain rule method this statement can be verified.

How many francs = Rs. 100 ?

Re. 1 = 1 s. $4\frac{11}{16}d.$ or $\frac{267}{16}d.$ (Bank's selling rate for demand bills)

240 d. = £1.

£1 = 11,840 francs (quotation of exchange on London at Paris).

Hence the required number of francs

$$= \frac{100 \times 267 \times 11840}{160 \times 240 \times 16} = 823.25 \text{ francs.}$$

Vested Interests.

The attempt of the Exchange Banks to perpetuate their new monopoly will never succeed.¹ Although they have once again succeeded in confining the exchange business of the Imperial Bank of India solely to its own customers, yet it is doubtful whether their monopolistic position will always prevail. Foreign exchange business is a paying one provided unnecessary competition between the exchange banks is eschewed altogether. As the resources of the Indian Joint Stock Banks increase the struggle for profits would become keen and there would be an effective challenge and real competition with the Exchange Banks. The newly arising national spirit prompts the people to retain these profits within the country. The desire to retain natural surplus profit arising from the financing of our foreign

¹ It reminds the readers of the monopoly maintained by the Australian Banks in the Commonwealth. No London bank can hope to secure a footing in the Commonwealth of Australia. The same is the attitude of the South African Banks. No London Bank can establish itself in Johannesburg. There is a ring of banks controlling the rates of exchange which are fixed for definite periods and advertised. Customers as well as banks outside this ring who have to buy exchange conduct their transactions through them. A market in forward exchange is impossible on account of this ring. There is a total lack of freedom and anonymity in the foreign exchange market as in other countries. See Philips, "Modern Banking and Foreign Exchange." Since these lines were written the situation has become much improved.

The Indian situation is not so hopeless as this but still the Eastern Exchange Banks have a thorough control over the exchange market.

trade,¹ so that our industries and commerce may have their necessary sinews of war, is becoming more prominent than before. As this national sentiment grows in intensity the Imperial Bank itself might be asked to finance our foreign trade and the present restrictions hindering the undertaking of general Exchange business might be removed or else a new Indian Exchange Bank may be started for conducting this business.

Our commercial banks would not be undertaking any risky business if they were to compete with the Exchange Banks for this Exchange business. Although the conversion of foreign money into domestic and *vice versa* is somewhat difficult as an element of speculation always enters in Exchange transactions between countries having different metallic currencies and although various influences operate on the rate of exchange,² yet it can be safely conducted if the banks realise the complicated nature of the business they have to perform and perform it with due caution. It would be preferable to have new Indian Exchange Banks worked solely by Indians and paying heed solely to Indian interests. It would be difficult for these Indian-owned and Indian-managed Exchange Banks to secure favourable treatment in London in the first instance. The Tata Industrial Bank was not given the same privilege for rediscounting bills by the Bank of England as was extended to the Eastern Exchange Banks.

Suggestions to overcome these Difficulties.

There should be an equal division of labour in the matter of discounting and handling internal and foreign bills of exchange.

¹ Indian economists point out that our foreign trade is wholly financed by the foreign banks and the annual tribute depends on the amount of trade that is financed by them. Our trade figures are estimated at Rs. 500 to 600 crores. Taking the lower figure as the basis of our computation and supposing that the average bank rate is 4 per cent. on an average usance of three months, the exchange banks would obtain a return of 5 crores a year.

² Clare says, "A rate of exchange is the condensed effect of a variety of facts and forces which are too numerous and too complex to admit of direct appraisement and in the majority of cases the best explanation we can give of an exchange movement is to pick out one prominent cause and hazard a guess at the others." See ABC of Foreign Exchange.

While the discounting of internal bills of exchange is not accompanied by any serious risk provided these banks discounted first class trade bills arising out of genuine trade transactions, the theory of banking dwells on the difficulties attending on the operations in foreign exchange and advises that bills arising out of export and import, *i.e.*, foreign trade and internal trade, are to be handled by different institutions, the former by the Exchange Banks, the latter by the domestic banks. It presupposes an intimate knowledge of the trade relations between the two countries and this can be grasped only after several years' experience. The relative value of the two currencies of the trading countries should be fully known and any likelihood of trading expansion in the near future should be clearly realised.

Dealings in Future.

Besides overcoming these initial difficulties the banks that undertake this business should avoid speculation in exchange on their own account. They should be careful in keeping their purchases and sales of exchange for various dates of delivery as nearly equal as possible. Occasionally they can make an excess of sales or purchases but broadly speaking an overbought or an oversold situation is not advisable.

For a safe and efficient conduct of this business branches in foreign monetary centres are necessary and the incidence of cost of such branches is very high in the beginning. Agents can however be employed but they might mismanage.¹ The foreign exchange department must be in the hands of a trained specialist. Clerks possessing good knowledge of foreign languages are necessary. The domestic needs or policy of the bank should be borne in mind by the head of the exchange department of the bank and it is difficult to keep both the domestic and foreign operations of the bank, each involving large outlay of capital, in close harmony with each other. The brokerage and establishment expenses must not be allowed to run high so as to absorb the margin of profit in exchange operations.

¹ The Alliance Bank of Simla which failed in 1923 was forced to open a branch in London on account of Messrs. Boulton Bros. and Co., who locked up their money in their own operations in the London money market.

Provided our commercial banks do not underrate these difficulties there would be nothing unwise nor would it be inherently unsound if they were to attempt to undertake Exchange business. It is by healthy and vigorous competition with such strong banks that the Indian-managed Exchange Banks can ever hope to learn their business and profit by it. It is unwise to restrict their entrance to this country.

Their Future Position.

It has been suggested that legal restrictions should be so framed as to permit them to obtain only current deposits for which a definite cash reserve has to be maintained and the proportion of Government securities or gilt-edged instruments held by them should increase to a greater extent than at present. There is no reason why the Exchange Banks should keep a dangerously low proportion of cash reserve in India against Indian deposits and although this position would automatically be improved by starting a Central Bank of Issue in whose hands a compulsory deposit of cash reserve would have to be made, the exchange banks ought to realise that the right to conduct banking business is a valuable privilege for the granting of which sufficient payment or *quid pro quo* can be exacted from them. At least the necessity of compulsorily training a number of Indian apprentices in banking business can be enforced on them.¹ This is what is done in the United Kingdom when aliens are allowed to carry on trade or business. It is considered their bounden duty to train the British subjects in the new processes. In actual practice the Exchange Banks of the Indian money market receive what amounts to a national treatment in every respect and the promotion of our national interest must be one of their primary objects or else the growing national sentiment of the country would make the situation rather too hot for them. The Indian people would simply follow the footsteps of the nationalists of China who are now taking vigorous steps to protect their economic interests. The Bank Clerks Union in Shanghai has issued the famous twenty-seven demands to their employers—the

¹ Another result would be the possibility of the Exchange Banks confining more attention to Indian business and fostering production in India. In times of stress and stringency they can rediscount these bills at the Central Bank of Issue.



foreign banks—and the carrying out of these demands would mean that the foreign banks can operate only by the grace of the Union.¹ Although we can eliminate the possibility of such a course of action in this country, no attempt should be made by the foreign banks to keep the Indian Exchange Banks that may be started in the future, weak and helpless for the promotion of their own ends.

It is nothing but sheer exaggeration to remark that "no important country of the world other than India has allowed foreigners to capture its banking activities." The power of the foreign banks is simply over-stated. As in China we do not find the foreign banks issuing notes² and controlling currency. The whole of the foreign trade lies in their hands but there is no trespass on our sovereignty by controlling the currency organisation by their own note-issues. It is the stability of these foreign banks that has added largely to their size and influence and the failure of every Indian Joint-Stock Bank has indirectly added to their prestige and deposit-attracting capacity. The distribution of these deposits is entirely a lop-sided business shifting towards larger and stronger institutions with the inevitable result that these have little business when compared with their resources.

¹ For an idea of the 27 demands of the Bank Clerks' Union, see Lt.-Col. P. T. Egerton, "China—the Facts," pp. 229-232.

² The Chartered Bank, the Hongkong and Shanghai Bank and the Mercantile Bank issue notes in denominations of \$1000, \$500, \$100, \$50, \$10, \$5 and \$1. In the month of September, 1927, their total issue amounted to \$62,589,730 against which a specie reserve of \$40,380,000 was kept. See Spalding's "Dictionary of World's Currencies," p. 94.

Table I showing the progress of the Exchange Banks.
(1,000 omitted.)

Years.	No. of Banks.	Paid-up Capital (£).	Reserve (£).	Deposits in India (Rs.).	Deposits outside India (£).	Cash balances out of India (£).	In India (Rs.).
1905	10	15204	7219	170445	94536	21504	37813
1910	11	21734	12610	247917	134166	17810	43851
1913	12	23640	14195	310354	181138	25688	58924
1914	11	22815	14157	301476	164920	40694	83937
1915	11	22581	14112	335456	179948	45111	76013
1916	10	22836	15095	380388	208232	41367	101401
1917	9	18384	14298	538253	228001	54765	337437
1918	10	22269	17180	618560	305397	57981	151755
1919	11	31931	21139	743590	433001	62571	299832
1920	15	54198	36019	748071	513671	84197	251753
1921	17	66369	45263	751961	526473	82318	235674
1922	18	66541	45680	733844	527348	91654	161763
1923	18	83038	56965	684428	894946	117915	14476
1924	18	72538	57926	606348	844682	114648	163669
1925	18	74230	64081	705457	923561	111758	94161

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(In Lakhs of Rs.)

Table II showing the Balance of International Accounts.

	Average of 5 pre-war years ending 1913-14.	Average of 5 war years ending 1918-19.	Average of 7 years ending 1925-26.	1926-27.	1927-28.	(a) Excludes transactions which do not enter into the balance of trade
Exports of Indian Merchandise (private) ...	+ 21950	+ 21598	+ 31255	+ 30143	+ 31911	(b) Exclusive of the value of Railway materials imported direct by State Railways working under company management.
Re-exports of Foreign merchandise (private)...	+ 462	+ 816	+ 1459	+ 801	+ 954	+ Plus represents net export.
Imports of Foreign merchandise (private) (b)	- 14585	- 14780	- 24449	- 22998	- 24678	- Minus represents net import.
Balance of trade in " "	+ 7827	+ 7634	+ 8265	+ 7946	+ 8187	A Union Government re- mittance such as net payment in India of foreign money and pos- tal orders and telegra- phic transfers on India from Iraq have to be deducted from the favourable balance of 1184 lakhs. If we de- duct this amount the favourable balance is 729 lakhs.
Gold (private) (a)	- 2886	- 781	- 2549	- 1940	- 1810	(See Report of the Control- ler of Currency, 1927-28, pp. 3 and 4.)
Silver " (a)	- 721	- 209	- 1373	- 1979	- 1385	
Currency notes (private) (a)	.....	.....	- 31	- 14	- 24	
Balance of transactions in Treasury (pri- vate) (a)	- 3607	- 1080	- 3953	- 3933	- 3219	
Total visible balance of trade	+ 4220	+ 6554	+ 4312	+ 4013	+ 4968	
Council Bills and t. to be paid in India, pur- chases of sterling from banks and firms in India and payments for sterling taken over in London from local bodies	- 4285	- 3496	- 2784	- 382	- 3777	
Sterling transfers on London sold in India	+ 5	+ 550	+ 673	+ 193	.....	
Transfer of Government securities	- 87	- 38	- 27	+ 3	+ 28	
Interest on drafts in respect of Government of India securities	- 45	- 30	- 33	- 34	- 35	
Balance of remittances of funds	- 4262	- 3014	- 2171	- 120	- 3784	
Total visible balance of accounts A	- 42	+ 3540	+ 2141	+ 3893	+ 1184	

Table III relating to Dividends and Price of their Bank Shares in India.¹

(Dividends per cent. per year.)

Exchange Banks.	Paid-up per share.	Quotation on 12-1-28.	1920	1921	1922	1923	1924	1925	1926	1927
1. The Chartered Bank of India, Australia and China ...	£5	£21 $\frac{1}{8}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$	20 $\frac{1}{4}$
2. The Eastern Bank ...	£5	(20-3-28) 94 Rs.	8 $\frac{1}{4}$	9	9	9	9	9	9	4 Int. Divid.
3. Hongkong-Shanghai Banking Corporation ...	£125	(12-1-28) £125 $\frac{1}{4}$	64	64	64	64	64	64	64	64
4. Lloyd's Bank ...	£1	(12-1-28) £3 $\frac{3}{8}$	16	16 $\frac{1}{2}$	16 $\frac{3}{4}$	16 $\frac{3}{4}$	16 $\frac{1}{2}$	16 $\frac{3}{4}$	16 $\frac{3}{4}$	16 $\frac{3}{4}$
5. Mercantile Bank of India ...	£12 $\frac{1}{2}$ A. £12 $\frac{1}{2}$ B. £5 C.	(1-3-28) £34 $\frac{1}{4}$ " 14 $\frac{3}{8}$	16 16 ...	16 16 16	16 16 16	16 16 16	16 16 16	16 16 16	16 16 16	16 16 16
6. National Bank of India ...	£12 $\frac{1}{2}$	(6-10-27), £49 $\frac{1}{4}$	20	20	20	20	20	20	20	10 Int. Divid.
7. P. & O. Banking Corporation	£10	(17-1-28), £9 $\frac{1}{4}$	...	3 $\frac{1}{4}$	5 $\frac{1}{4}$	5 $\frac{1}{4}$	5 $\frac{1}{4}$	5	5	5 Int. Divid.

¹ See "Commerce," March, 1928, p. 672.

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CHAPTER V

ORGANISED BANKING IN THE DAYS OF JOHN COMPANY

Number of European Banks—Different lists—The first Banks of 1688 and 1720—The Carnatic Bank—The Second Government Bank of Madras—Government Savings Banks—The Bengal Military Bank—Complete and Correct list of European Banks—Agency Houses—Their Failures.

Number of European Banks.

There is no more obscure subject in Indian Economic history than the growth and operations of the European Joint-Stock Banks and the indigenous banking houses which conducted their business in India during this period. It has remained and is bound to remain for a long time an unwritten chapter in the history of Indian Banking as these banks did not publish valuable statistics and other data stating precisely their assets and liabilities which would be of service in any scientific account of them. A few official papers of great importance, which have not been used so far by any writer on Indian Banking, really throw a valuable light on the development and the state of exchange and monetary conditions of that time.

There are four publications which attempt to throw light on the banking institutions working during this period. MacGregor writing in 1848 enumerates the banks of this period in his *Oriental Commerce*, Part XXIII, which forms a part of his wider work "*Commercial Tariffs*." The next writer, R. M. Martin, furnishes us a list of banks in existence in India during the years 1803-1854.¹ There is a Parlia-

¹ R. M. Martin, *Indian Empire*, Vol. I, p. 165.



mentary return of the year 1860 which gives us the following list of the banks doing business in India at that time.¹

Bengal.	Madras.	Bombay.	Country Banks.
Bank of Bengal.	The Bank of Madras.	The Bank of Bombay.	The Dacca Bank.
The Agra and United Service Bank.	Branch of the Agra and United Service Bank.	Branch of the Agra and United Service Bank.	The Delhi Bank.
The Chartered Bank of India, Australia and China.		Branch of the Chartered Bank of India, Australia and China.	The Simla Bank.
The Chartered Mercantile Bank of London, India and China.	Branch of the Chartered Mercantile Bank of London, India and China	Branch of the Chartered Mercantile Bank of London, India and China.	The Uncovenanted Service Bank of Agra
The Commercial Bank of India.		Branch of the Commercial Bank of India. ²	
The North-Western Bank.		The Government Savings Bank.	The Agra Savings Bank.
The Oriental Banking Corporation.	Branch of the Oriental Banking Corporation.		
The Government Savings Bank.	The Government Savings Bank.		

Different Lists.

To have an idea of the banks conducting business in the earlier years reference must be made to MacGregor. His publication already referred to enumerates the banks doing business in Calcutta, Bombay, Madras and Ceylon. It was natural on his part to make no reference to the country banks which undoubtedly existed at that time as his work was solely concerned with commerce at the chief port centres. Coming to his list we find the following banks mentioned by him :

Calcutta.	Bombay.	Madras.	Ceylon.
The Bank of Bengal.	Besides the banks of the town there are branches or agencies of other banks. (He does not however specify the names of the banking institutions.)	The Bank of Madras. (The branches of other banks are not mentioned by him.)	The Bank of Ceylon.
The Union Bank.			
The Agra Bank.			The Oriental Bank.
The Bank of Western India (Calcutta Branch.)			

¹ See the Collection of Parliamentary Papers, 1843-1870, in the Library of the University of Calcutta—Document c. refers to the banks existing in India in 1860.

² Compare this with Martin's list,

Of the two banks in Ceylon—the Bank of Ceylon and the Oriental Bank—MacGregor gives interesting details which are not furnished either by Cooke or any other recent writer as regards their capital, nature of business and note-issue. The Bank of Ceylon was a Bank of Issue incorporated by Royal Charter in 1840 and confined its business solely to the Island of Ceylon. But to facilitate its exchange business it had agencies in the Presidency Towns of India. Its circulation of notes amounted in 1840 to £127,487 according to MacGregor. The Oriental Bank had its head office in London and also a Board of Directors in Bombay. It had considerable operations at Calcutta, Madras, Canton, Hong-Kong and Singapore. Its note-issue in 1846 was about £15,000. The total capital of both the banks as applied to Ceylon was very limited being about £100,000 to £125,000. In addition to exchange business and the sale of bills in England and the Presidency Towns of India they received deposits and discounted local bills for merchants and traders. The latter were mainly comprised of purchases made by the chetties from importers chiefly of British produce and the acceptances of the Moormen retailers whose paper was for smaller amounts proportionate to their minor transactions. Speaking of the gradual growth of their banking business the transactions of 1846 rose roughly to two millions while in 1845 they amounted to only one and a half millions. MacGregor also testifies to the absence of speculation on the part of the merchants of Ceylon.¹

R. M. Martin who seems to be a more careful writer than MacGregor gives us the following table which shows at a glance the work of the banks of this period (1803-1854). As certain errors have to be corrected the full list has necessarily to be quoted.

¹ See "Oriental Commerce," pp. 711-712.

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Col. 1	Col. 2	Col. 3	Col. 4	Col. 5	Col. 6	Col. 7	Col. 8	Col. 9
Name of the Bank.	Year of Estab-lishment.	Head Office.	Branches and Agencies.	Capital sub-cribed.	Paid-up Capital.	Notes in circulation.	Specie in coffers.	Bills under discount.
1. The Bank of Bengal.	1809	Calcutta	...	10,70,000	10,70,000	17,14,711	8,51,964	1,25,251
2. The Bank of Madras.	1843	Madras	...	3,00,000	3,00,000	1,23,719	1,39,960	59,871
3. The Bank of Bombay.	1840	Bombay	...	5,22,000	3,22,000	5,71,089	2,40,073	1,95,836
4. The Oriental Bank.	1851	London	...	12,15,000	12,15,000	1,99,279	11,46,529	2,91,8393
5. The Agra and United Provinces Bank.	1833	Calcutta	Agra, Madras, Lahore, Canton and London.	7,00,000	7,00,000	...	74,362	...
6. The North-West Bank.	1844	"	Bombay, Simla, Mus-suri, Agra, Delhi and Cawnpore.	2,20,560	2,20,000	...	...	...
7. The London and Eastern Bank.	1854	...	...	2,50,000	...	3,2,5000	...	...
8. The Commercial Bank.	1854	Bombay	Agents in London, Calcutta, Canton and Shanghai.	10,00,000	4,56,000	...	...	...
9. The Delhi Bank	1844	Delhi	Agents in London, Calcutta, Bombay and Madras.	...	1,80,000	...	...	...
10. The Simla Bank	1844	...	...	...	63,850	...	...	...
11. The Dacca Bank	1846	Dacca	...	30,000	...	...	...	...
12. The Mercantile Bank.	...	Bombay	London, Calcutta, Colombo, Kandy, Canton and Shanghai.	5,00,000	3,28,826	7,77,156	77,239	1,09,547
13. India, China and Australia Bank.	...	...	...	...	...	...	Did not commence business as yet.	...

A comparison of this list with the Parliamentary one and the final list prepared by me would disclose certain discrepancies. Firstly the Head Office of the Commercial Bank is stated to be located at Bombay by Martin. The Parliamentary list which must be considered as a more authoritative source locates it at Calcutta. The Oriental Bank is supposed to be started in 1851 according to Martin's list. But it was first started in 1846 and it became the Oriental Banking Corporation in 1851 by virtue of its amalgamation with the Bank of Ceylon. This was done mainly in order to annex the note-issue privilege of the Bank of Ceylon. This mistake in the matter of date is not due to Martin, but Dr. Ambedkar who quotes the above list which contains however no dates, fills in the dates column and the discrepancy in date must of course be attributed to Dr. Ambedkar.¹

Cooke records the work of thirty-nine European Banks which have been started in India or London during this period mainly with the view of conducting banking business in India. But even this list is not an exhaustive one for he fails to mention the names of some of the earlier European Banks of the 18th century. It is evident that his information of the Earlier European Banks is very scrappy and is chiefly confined to few details of these operations as could be gleaned from the early records of the Bank of Bengal. It is evident that he has not consulted any of the periodicals and newspapers or else he would not have omitted the work of the three Military Banks of Bengal, Bombay and Madras.

A recent writer who comments in an interesting and detailed manner on the methods of the Early European Banks in Calcutta² bases his information on the Selections of the Calcutta Gazette and by a reference to the Government records of that time in the India Government Record Office and the Secretariat Office of the Government of Bengal he has succeeded in pointing out the qualitative aspect of the work of the Early European Banks in Calcutta, *viz.*, the Bengal Bank, the Hindostan Bank, the General Bank of Warren Hastings and the Bank of Calcutta which became rechristened as the Bank of Bengal as soon as it received its Charter in 1809. His book dealing with this period is confined solely to Banks of the

¹ See Dr. B. R. Ambedkar's "Problem of the Rupee," footnote, p. 37.

² See Dr. H. Finsa, "Early European Banks," Part I.

City of Calcutta and he makes no reference to the earlier Banks which did business before the actual starting of the Bank of Hindostan. The contemporary Madras Banks are not referred to. He does not even mention the name of the Carnatic Bank.

Dr. P. Banerjea in his valuable lectures on the state of finance of the East India Company has given the public a glimpse into the nature of the work of the banks existing during these years—1770-1857. He succeeds in throwing more light on the General Bank of Warren Hastings which should not however be mistaken for the General Bank of India started in 1785. The attempt of Warren Hastings to organise the Bank and thus perfect the means of easy and safe remittance from the moffusil into the metropolitan city and the nature of the work of this short-lived institution are first outlined clearly in Price's History of Midnapore. Some more details are given by Dr. Banerjea.

Before the work of these banks which have not been mentioned by these previous writers including Cooke and Brunyate can be taken up in detail, a reference to Cook's list should be made.

<i>Name of the Bank.</i>		<i>Year of its starting.</i>	
1.	The Bank of Bengal	1806, chartered in 1809.	
2.	The Bank of Western India	...	1842
3.	The Oriental Bank	...	1846
4.	The Oriental Banking Corporation	...	1851
5.	The Bank of Madras	...	1843
6.	The Government Bank of Madras	...	1805
7.	The Bank of Bombay	...	1840
8.	The Union Bank	...	1829
9.	The Bank of Hindostan	...	1770
10.	The Commercial Bank	...	1819
11.	The Calcutta Bank	...	1824
12.	The Bank of Mirzapore	...	1835
13.	The Agra and United Service Bank, Limited	...	1833
14.	The North-Western Bank of India	...	1840
15.	The Delhi Bank Corporation	...	1844

<i>Name of the Bank.</i>		<i>Year of its starting.</i>
16.	The Dacca Bank	1846
17.	The Benares Bank	1844
18.	The Simla Bank, Limited	1844
19.	The London and Eastern Banking Corporation	1854
20.	The Cawnpore Bank	1845
21.	The Uncovenanted Service Bank, Limited	1846
22.	The Agra Savings Fund	1842
23.	The Commercial Bank of India	1845
24.	The Government Savings Bank	1833
25.	The Chartered Bank of Asia	1852
26.	The Mercantile Bank of India, London and China	1853
27.	The Chartered Mercantile Bank of India, London and China	1858
28.	The Bank of Ceylon	1840
29.	The Chartered Bank of India, Australia and China	1853
30.	The Punjab Bank, Limited	1860
31.	The Sindh, Punjab and Delhi Bank Corporation, Limited... ..	1860
32.	The Central Bank of Western India, Limited	Nov., 1860
33.	The Bank of Hindostan, China, and Japan, Limited	1862
34.	The Bank of Rohilkand	1862
35.	The People's Bank of India, Limited	1860
36.	The Comptoir D'escompte of Paris... ..	1860
37.	The Bengal Bank	1790
38.	The Bank of India	1828
39.	The Carnatic Bank	?

Besides the above-mentioned banks which conducted business for some time, Mr. Cooke also mentions the unsuccessful attempts that were made during this 'period to start banks in London with the sole



purpose of conducting banking business in India. He casually mentions the attempts of the London merchants to found the "East India Bank" in 1836.¹ R. M. Martin strove his level best to secure a charter for his projected Bank of Asia in 1840.² Similarly in 1852 the London Bank of Australia and India was projected but owing to the opposition of the Colonial Office in London it failed to secure a Charter. But it is strange he does not mention the attempts made in 1822 and 1827 to found Banks in Bombay.

Since Cooke wrote the memorable lines that "probably the first banking institution in India on European lines" was the Bank of Hindostan started in 1770 it has become the accepted article of faith among writers of Indian Economic history. This statement has to be accepted with much qualification. It must be understood that banks must have operated in India with either good or bad fortune even before that date. It is usual to consider the Government Bank of Lord William Bentinck as the only Government Bank conducted by the Government of Madras. As a matter of fact there were two such Government Banks conducted by the Madras Government. No mention has been made by any other writer of the attempts made in Bombay to conduct banking business by the Government Bank started by the Government of Bombay. Even as regards some of the banks started in Bengal Cooke throws little light on their operations. For instance the General Bank of Warren Hastings is not mentioned by him. His description of the work of the Government Savings Bank is not fairly lucid. No information can be obtained from Cooke's book as regards the first Government Bank of Madras and the Carnatic Bank. He does not even mention the names of the British Bank or the Asiatic Bank. Even in the case of the joint-stock banks of the North-West Provinces only very little light is thrown on their operations. Although he has given very interesting details of the Agra Savings Bank or Agra Savings Fund, as he styles it, still the three Military Banks did not attract his notice.

¹ For greater details see a pamphlet entitled "Reasons for the Establishment of a New Bank in India" 1885, London; a copy of this exists in the Imperial Library, Calcutta.

² See Parliamentary Paper entitled "correspondence relating to the projected Bank of Asia"—Document C of the Parliamentary Papers, 1840-1870.

The First Bank of 1688.

Most probably the credit of starting the first European-managed banking institution belongs to the benighted province of Madras. It was however a Government institution managed by its officers belonging to the Council.¹ It must have been started in 1688 as the following notification which appears in the Fort Saint George Gazette clearly proves this fact:—

“By the Hon'ble East India Company's order we the Agent and Council of the Fort Saint George do hereby publicly declare unto all parties whatsoever that we will at any time take up and receive what sums of money soever should be brought to us at six per cent. per annum. Interest for six or twelve months' time or any longer term of years but no less than six months nor to exceed this time we shall agree for and we shall for the better security of such persons that shall so let out their money give our receipt for the same under the Honorable Company's seal.”

A close scrutiny of the prior records of the Government discloses the information that it was in 1682 that the Hon'ble the East India Company recommended the Government of the Fort Saint George to obtain a loan by constituting itself a Bank for the receipt of fixed deposit. Hence Governor Gyfford promptly resolved to raise a bank of money to the value of One Hundred Thousand Pounds at six per cent. rate of interest.² Thus it becomes apparent that in order to augment the territorial revenues of Madras the plan of starting the Government Bank on the model of the London Goldsmith's Banks was mooted by the Hon'ble the East India Company. It is not clear whether it issued notes also but there is no doubt that it acted as a bank of deposit and discount.³

The Bank of 1720.

Chronologically viewed the next attempt at founding an organised Bank was made in Bombay. This time again it was the Government

¹ See Talboys Wheeler, “Madras in the Olden Times,” p. 71.

² See P. C., Vol. III, 21st June, 1683. Quoted from Love “Old Records of Madras.”

³ See Mrs. Penny, “History of the Fort Saint George.” Prof. Dodwell holds a contrary view and does not consider it as a Bank but only thinks that the word “bank” was used in the literal dictionary sense of the term and that its banking operations cannot be traced in full. See his “Report on the Records of the Madras Government,” p. 85.

that pioneered the way. The following extract from the Bombay Government Diaries clearly proves that a Bank existed in Bombay prior to the starting of the semi-Government or what is properly termed as the Presidency Bank of Bombay in 1840. From a perusal of the Consultations of 20th June, 1720, we find that a Bank was to be organised as this suggestion was approved by the Hon'ble the Court of Directors. Messrs. Brown and Phillips, members of the Bombay Council, were appointed to devise a scheme for the regular carrying on of the banking business. The increase of revenue was the object of the Council and like the impecunious Government of Madras which did banking business in 1689 in order to augment its revenues one of the objects of the Bombay Government was to increase the revenues by undertaking banking business. The scheme was duly prepared by Messrs. Brown and Phillips and placed before the Council for approval on 25th July, 1720. The "black merchants" were also taken into confidence and the scheme was sanctioned at the same sittings of the Council. The managers of the Bank were to receive one per cent. of the profits for their trouble. The Bank commenced its operations and until 1724 no remuneration was actually paid to the Assistant of the Bank when it was resolved to award a gratuity of £50 per annum.

From a perusal of the Consultations of the Bombay Council for the year 1727-1728, dated 1st March, 1727, we find that the Bank was conducting business at that time in Bombay. The two petitions read before the Council from the Mayor's Court clearly suggest that the "two thousand Rupees the amount of fine now standing upon the books to be appropriated towards a new person be taken out of the Treasury and employed in the Bank at interest or entrusted in the hands of the said Court for answering the most necessary occasions of the said Court."

The very great scarcity of specie in 1770 in the Island of Bombay led the Government to discover some means by which the currency situation might be eased to any appreciable extent. One Mr. Taylor, a member of the Council, proposed the issuing of bills from the Bank on loans upon the present security. "It was resolved that this plan should be put into execution and that notes be immediately prepared to the amount of the debt due from the Treasury to the Bank being

with interest about Rs. 8,00,000. The notes to be from forty to one thousand rupees each signed by the manager of the bank and sealed with the Hon'ble Company's seal."

This original plan was greatly improved by an officer of the Bank of England, Mr. Robert Blatchford, and his final draft of the proposal was to make the Bank, a bank of deposit and issue. The bank was to be privileged to issue notes up to 8 lakhs of rupees only. The Treasury should in the beginning assist the bank with one-third of eight lakhs of rupees in specie and notes up to this amount should be retained by the Treasury to be returned when specie is repaid.¹ Persons who borrow money from the Bank should undertake to encourage the circulation of the notes which were to carry interest payable only after the expiry of ten days. The form of notes was to be exactly similar to the notes of the Bank of England. So as to protect the gentlemen of the Council who are to manage the Bank the form of the note was to be signed in the following manner: "For the Court of Directors of the United East India Company," thus making the East India Company alone liable for the notes. The first notes of the Bank were to be of the following denominations for each lakh of rupees:

Rs.				Rs.			
10	of	1,000	each	...	...	...	10,000
24	of	500	"	...	...	...	12,000
24	of	300	"	...	...	...	7,200
100	of	200	"	...	...	...	20,000
200	of	100	"	...	...	...	20,000
400	of	50	"	...	...	...	20,000
540	of	20	"	...	...	...	10,800
Total							100,000

¹ This plan should be compared with the scheme of Warren Hastings to issue notes in Bengal in 1780 against the deposit of Sicca Rs. 30 lakhs lying in the Treasury in the New Fort William. He adopts the same form as this so as to exonerate the officials from all liabilities with reference to notes issued under their signature. This plan was not however carried out as the notes issued by an impecunious Government could hardly have circulated. The similarity between the two plans is striking and Warren Hastings' plan might have been borrowed from a perusal of the plans of the Bombay Government.

It has already been related that an officer of the Bank of England was requisitioned for improving the original plan of the Bank determined by the Bombay Council. The first notes of the Bank of England were issued exactly in a similar manner. A specimen of the

It was understood that as time and experience alone would enable it to find what denomination of notes are in great demand, that portion of the notes for which there were to be no demand was to be destroyed and replaced to that amount by those which appear to be most in demand. Thus it clearly proves that no bank notes circulated prior to this date in Bombay or else previous experience would have been drawn upon in the determination of the denominations of the notes. Another significant fact that has to be noted is the round figure for which the notes were to be issued. When compared with the first specimen notes of the Bank of England it would be noticed that they were for broken denominations including shillings and pence even. At any rate the Bombay Bank's note was to be an improvement on this old form of the note of the Bank of England.

As only eight lakhs worth of notes were to be issued it was wisely resolved that no person was to be lent more than Rs. 8,000 at any one time and the Bank should consider any second application for notes on its own merits. This shows that the Bombay Council seems to have dimly perceived the principles of sound banking, *viz.*, that all eggs were not to be placed in the same basket and that the Bank should distribute its capital in the hands of all deserving applicants and that credit should be created without any bias, be it communal, religious or political.

It was also determined to attract current accounts and pay a deposit rate of interest, *viz.*, five per cent.

The Bank must have conducted business for some years for we find it recorded in July, 1778 that " the debt from the Treasury due to the Bank amounted to a very large sum " and it was swelled to a large extent by the annual interest payable thereon. The Council felt great anxiety on this score and wrote to the Hon'ble the Court of Directors

1699 Note of the Bank of England is appended to enable the reader to note the points of similarity in the matter of note-issuing.

27 April

J. V.

I promise to pay to Mr. Daniel Denny or Bearer on demand the Summe of One Hundred and fifty pounds eight shill and eight d.—For the Governor and Company of the Bank of England John (Wase).

London the 24 day of Jany. 1699

See R. D. Richards, Quarterly Journal of Economics, Vol. XLI, p. 399.

to give it specific instructions "whether to fix it at a certain sum or to write it off altogether and establish a new bank whenever the state of our finances will permit."¹

This Bank might not have issued large amount of notes for latter-day ² writers have often mentioned that previous to the foundation of the Presidency Bank of Bombay in 1840 "paper money was almost unknown in mercantile transactions of Bombay" as at Calcutta and Madras.

Passing on to the territory of Madras we notice that Lord Macartaney also strove to raise a Bank of money meaning thereby a "public treasure" in connection with the settlement of the Carnatic Nawab's and the Tanjore debts. His plan was that the Bank should keep one-third of its funds in specie and lend two-thirds on good bills or valuable pledges at six per cent. He opined however that this would convert Madras into "a shop of pitiful usury instead of a city of honourable commerce."³

The Carnatic Bank.

The present knowledge of the writers on the Carnatic Bank, a banking institution of this period is confined only to the single paragraph written by C. N. Cooke. He refers to the Carnatic Bank in the following language. "This is the name of a Bank which was in existence at the Madras Presidency in 1791. At present we are without knowledge of the proprietary body and other particulars."⁴

All the latter writers including Symes Scutt repeat the same information and have nothing to add.⁵ Even in the book on the

¹ More details have been gathered by the present writer of the state of early banks of Bombay which would be published as soon as the Government of Bombay would permit him to publish the information gathered from their manuscript records.

² See J. MacGregor, *Commercial Tariffs*, Part XXIII, p. 661. See also the pamphlet, "The late Government Bank of Bombay," 1868. This does not however mention any details as regards the note-issue of the Bank of Bombay (1840-1868). It is in reality a history of the Bank of Bombay from 1863 to 1868. Something more can be actually written from a thorough study of the evidence of the witnesses before the Sir C. Jackson Committee. See also C. N. Cooke, *Banking in India*, p. 175.

See also Symes Scutt, "History of the Bank of Bengal."

³ See the *Military Consultations*, 17th April, 1782, p. 1064, quoted by H. Dodwell in the *Records of Madras*.

⁴ See C. N. Cooke, "Banking in India," p. 392.

⁵ Symes Scutt, *History of the Bank of Bengal*.

Early European Banks no mention is made of the Carnatic Bank which undoubtedly must be considered as one of the earliest of the European Banks conducting business in this country. It is indeed a wonder why these writers did not refer to any published records on the Madras Presidency dealing with the history of the Province in the last years of the eighteenth century. It is a curious anomaly to style a book as dealing with the Early European Banks while only the European Banks in Calcutta are taken into account. A large number of banks doing business in other provinces are not even mentioned. There is no description of this Bank's work in the Madras Presidency in the recently published work of Dr. Banerjea on "Indian Finance in the Days of John Company."¹

The History of the Carnatic Bank.

A scrutiny of the State Records of 1788 has enabled the industrious writer Mr. H. D. Love to point out that this was the first joint-stock bank in Madras founded under the title of the Carnatic Bank during the tenure of the Governorship of Sir Archibald Cambell.² The founders of the Carnatic Bank were Josias Du Pre Porcher of Fort Saint George and Thomas Redhead of Calcutta, John Balfour, John Chamier, Edward Raphael, Thomas Cookburn, Benjamin Torn and N. E. Kendersley who was a member of the Board of Trade also. The object was to receive money, issue bills and notes and discount bills and notes and other securities "after the manner of the most respectable bank in London." Its capital was 120,000 Star Pagodas divided into eight shares held by the above-mentioned founders. Power was taken to appoint a cashier, clerks, servants and to issue notes to the value of three times the capital and the Bank began issuing its notes in 1788.³

¹ Dr. Banerjea says, "In the Madras Presidency an institution bearing the name of the Carnatic Bank existed in 1791 but very little is known about its activities." See his article on Banking in the Days of John Company, Calcutta Review, November, p. 137. Nothing further is stated in the bigger book of his dealing with the finances of this country in the Days of John Company.

² See P. Miss, Vol. 11, 11th August, 1791, for greater details.

³ See P. C., Vol. CL, 11th August, 1788 for greater details which are not however of great importance.

On 22nd December, 1790 we find the Carnatic Bank issuing a notice in the Fort Saint George Gazette that no business will be transacted at the Bank either on X'mas or New Year's Day. Mr. John Hunter who subsequently became the director of the British Bank was the then Cashier who signed the notification. Evidently in the absence of a Negotiable Instruments Act fixing the number of Bank Holidays, the banks had to issue general notifications indicating the bank holiday.¹ A similar list of bank holidays at the Bank of Bengal was published by the latter institution in 1837. The list was the same as that allowed by the Moffusil Courts of the East India Company in the Province of Bengal, or the Treasury and the Sudder Dewany Adawlut.

Messrs. Porcher and Redhead were the original proprietors of the scheme and were also the directors of the Bank of Hindostan doing business at Calcutta. They not only gradually² secured the shares which the other proprietors wished to dispose of but Porcher was appointed as a permanent Director and two other Directors were chosen to help him. Thus he can be considered as the first Managing Director of an Indian Bank. This system still persists in this country in spite of its apparent defects.

It was at the suggestion of Mr. Porcher that the Carnatic Bank approached the Madras Government with the request to support it in its endeavour to give the rupee a more easy and extensive currency at the established rate of exchange. Hitherto we have been able to receive that coin at the bank but if the Government will be pleased to authorise the receipt of our notes at the Treasury to any limited

¹ The List of Holidays.

(See the Asiatic Journal, July, 1838, p. 151, and January 1838, p. 7.)

<i>Christian</i>	<i>Hindoo</i>	<i>Mahomedan</i>
N. Year's Day, Good Friday, X'mas, Sundays.	Mucker Sankratri, Sree Punchamy, Seebo Ratree, Dole Jatra, Barone, Sree Ramnavami, Churok Pujah, Dhuserah, Seenain Jatra, Ruth Jatra, Ooltah Ruth Jatra, Ratee Poorneam, Jumoo Ostami, Oononte Brotto, Mahalaym I, Durga Pujah I, Kalee Pujah 2 Bharata Dotna I, Ross Jatra, Kartic Pujah, Juggadhatri Pujah, Deotan.	Shubrath, Ed, Buckred, Muharam, Akharee Chursunk, Bawray Buffa.

It was only in 1863 that Saturday was declared a half-holiday and the Bank worked till 2 P.M. alone. See Symes Scutt, "History of the Bank of Bengal."

² In 1791 Balfour and Raphael sold their shares to John De Fries Junior and Porcher and Redhead respectively.

extent they think proper we will make arrangements for the receipt of rupees and issue notes accordingly. There cannot be any risk out of this step (I.E.) granting this indulgence to say one lac fifty thousand pagodas and the great object of fixing the currency of this rupee will be considerably forwarded by it and a great convenience would naturally result both to the Government and individuals who find it difficult to receive or pay away a larger sum than one lac of rupees in course of the morning and the shroffing of which, the expense is considerable, will be saved to individuals."¹

But the Madras Government refused to grant any concessions and this must have been the result of the Court of Directors' order, dated 10th January, 1787, enjoining on the local authorities in India not to have any dealings with private banks nor encouraging them in any way.² The Court of Directors also held the opinion that the Agency Houses and the indigenous bankers were better fitted to meet the banking needs of the community than the European banks. In the then circumstances of the Indian society the utility of banking institutions was considered doubtful. Hence it forbade any connection

¹ This letter to the Government from which the above extract is taken was signed by the following directors of the Bank—Jos Du Pre Porcher, Thomas Cockburn, John D'Fries Junior, Jos Du Pre Porcher for J. Chamier and Thomas Redhead, Esq., Porcher Redhead for J. Chamier and Thomas Redhead, Esq., Porcher Redhead & Co. for Messrs. Torn and Kindersley. For the copy of the original letter see P. C., Vol. CLXX, 8th July, 1791.

² This order was not directly carried out by the Bengal Government which actually decided to loan five lakhs of sicca rs. to the Bengal Bank and one-half lakhs of sicca rs. to the Hindostan Bank in 1791 on the deposit of Company's paper to the amount required (25 per cent. in addition thereto in the case of the Bengal Bank was also insisted upon). The Bengal Bank could not take advantage of this liberal offer. The Hindostan Bank paid off the loan within the stipulated period of two months and soon regained its position in the money market. References to this Bank can be met with in 1799 as well as 1807. The Bank of Hindustan acted as the Agent of the Calcutta Exchange Lottery and sold its tickets in 1793. (See Symes Scutt, History of the Bank of Bengal.) Again in 1807 we find the Government of Bengal making use of this Bank for inviting tenders for constructing a mausoleum over the grave of Lord Cornwallis at Ghazipore. The Bengal Military Bank deposited a part of its balances in this Bank to secure the deposit rate of interest.

The Bengal Government easily justified its help on the ground that if the Banks were to fail, the value of Government paper would be adversely affected, that Government contractors would fail and the faith of the holders of the Government securities would be easily shaken and undesirable political complications might result out of this step.

whatsoever with the private bankers. As a result of such explicit instructions the Madras Government refused to employ the agency of the private bank in money negotiations and encourage it in its attempts to extend the popularity of the rupee though reciprocal convenience could have resulted out of this step.

The Carnatic Bank however continued its business and in 1798 it was appointed along with the British Bank to receive the deposit of lottery money. When it ceased to exist is difficult to ascertain, for the chroniclers of this period have failed to provide us with any authentic record. Evidently it might have failed immediately after 1808 when Lord William Bentinck's Government Bank started its business in right earnest. The actual rivalry of the three existing banks—the Carnatic Bank, the British Bank and the Asiatic Bank—led to the necessity of creating a trustworthy bank.

The British Bank mentioned in the above paragraph was a contemporary institution conducting business in Madras at about this time. No writer on banking has even mentioned the name of this bank. The Directors of the British Bank were George Westcott, Thomas Lorimer, Robert Woolf, Francis Lantone and John Hunter. The last-named individual acted as the cashier of the Carnatic Bank and we find that it was in existence by 1795. In 1798 it was appointed along with the Carnatic Bank to receive the deposit of lottery money. Another mention of the British Bank can be traced in the Government records when the value of its building was estimated at about 7,500 star pagodas. There was also in existence another bank known as the Asiatic Bank conducting business in 1805. The keen rivalry which existed among the three banks made the general public dissatisfied with their business and Lord William Bentinck organised his plan of the Government Bank in those days when private credit failed to create the needed banking machinery.

The Second Government Bank of Madras.

Even of the work of the second Government Bank at Madras started by Lord William Bentinck in 1805 very little is known. Cooke says that it conducted business on a very small scale and had a



note circulation of a very limited amount. Brunyate considers it "more a treasury than a bank."¹ Not one of the recent writers gives us more information than these two writers.

The origination of the Government Bank was due to the recommendation of the Second Finance Committee appointed to consider the state of finances of the Presidency of Madras. The First Finance Committee was appointed in 1798 and sat till 1800. Different subjects like the management of the Lottery Fund and the establishment of the Government Bank to help the conditions of the junior members of the Company and the reorganisation of the Post Offices were some of its recommendations. The Bank of Issue could not be started for nothing definite as regards Government control was stated therein.

One of the recommendations of the Second Finance Committee which submitted an *ad interim* report in Nov., 1805,² was to start a Bank of Issue on lines similar to those recommended by Henry St. George Tucker in his letter to Lord Wellesley written in 1801. The only difference was that the Government should not subscribe any share capital nor were there to be any Government Directors. There was no individual private capital to have recourse to and no individuals like shareholders interested in maintaining its credit.

The part played by Lord William Bentinck in the founding of this Bank is not mentioned by any other writer and is worth recording as it shows the foresight of that distinguished nobleman who later on won laurels for his improvements in the Civil administration of the Government. He thought that in order to have extended paper currency the best means would be to start a Government Bank

¹ See J. B. Brunyate, *An Account of the Presidency Banks*, p. 29.

² The second Finance Committee sat till 1808. It was of opinion that though gold pagodas were in circulation silver was the only suitable currency and as there were numerous coins with fluctuating values which only tended to increase the shroff's profit in converting them into change, it was proposed to adopt the Bengal Rupee as the single standard of value. Up till 1815 this diversity of coin existed and an examination of the Government Treasuries revealed that there were roughly 72 varieties of gold coin, 60 varieties of silver and 25 varieties of copper. These were gradually called in. Single and double pagodas were issued together with rupees, half-rupees, quarter-rupees and two-anna pieces. In 1818, it was decided to replace the star pagoda by the silver rupee as the coin of account. (See *Public Consultations*, 27th July, 1815, p. 1999, and 7th Jan., 1818, No. 17.)

which would always have the accommodation of the Public Treasury.¹ As he could not secure support for his scheme in the Council the Bank was started in the second week of Dec., 1805,² without even consulting the Supreme Government. He acted as the sole director of the Bank and its notes were received at all the Public treasuries in lieu of cash.

This plan of the Madras Bank was forwarded to Henry St. George Tucker for favour of his esteemed opinion and from his trenchant criticism the following points of the Bank administration can be gathered. He says "it is deficient in two of the most essential requisites of a Bank. It is neither calculated to obtain the confidence of the public nor does it provide the means of aiding the operations of commerce. The Madras Bank will not in my opinion be distinguished from the public treasury. It will be involved in all the money transactions of the Government. It will participate in its difficulties and its credit will be least when it has most occasion for credit in time of public distress. Lord William Bentinck contemplates this and makes provision for suspending cash payment as done in England during 1797 and after." The original plan of the Bank was to issue notes only and the idea of acting as a bank of deposit and discount at the same time did not enter into the mind of the founder. Mr. Tucker was quick enough to recognise the limited utility of a bank of issue and criticised the above conception on the following ground that "if the amount of specie which it was to keep in reserve was as much as the actual amount of notes in circulation there would be no augmentation of the circulating medium." A minor point of criticism was "that it was not so framed as to secure the greatest economy in its management." As the Governor chose to be sole director his other duties would be so exacting that there would be very little time to pay adequate attention to supervise the duties of the Bank and the real affairs would after all be managed by subordinate officers having no direct responsibility.

This lucid criticism must have had a certain salutary effect in bringing about improvements in the Government Bank of Madras. It

¹ See Public Consultations, 29th Nov., 1805, p. 5709.

² See *ibid.*, 6th Dec., 1805, p. 5793

also undertook deposit and discount business. Its notes were received in the public treasury but "they had scarcely any circulation in the Province of Madras itself."

Occasional reference to its officers can be traced in the Government Records of the time. One Richard Yieldham, a free merchant who settled in Madras, acted as the Treasurer of the Government Bank.

The Government Bank was located under the Exchange in 1807. Important changes took place during the years 1807 to 1809 and no writer on banking has chronicled these significant facts. Mr. Petrie, who had to act as the Governor in place of Lord William Bentinck who was recalled as a result of the Sepoy Mutiny at Madras, refused to act as the Director of the Bank and appointed four *ex-officio* Directors—the Chief Secretary, the Mint Master, the Accountant-General and the Sub-Treasurer. The Court of Directors condemned the starting of this bank without their advice or consent being taken and directions were issued to follow the proposed regulations of the Bank of Calcutta. The Accountant-General had to undertake this task of reorganisation and all the notes issued hitherto were recalled by a Proclamation, dated 29th Nov., 1808. For a period of two years an attempt was made to reconstruct the Bank allowing the Government to subscribe one-fifth of the total five lakhs of pagodas of capital. The Bank was to be placed on a limited liability basis. The notes were to be current only in the Madras Presidency. The Government was to nominate five out of nine directors. The Bank was to discount bills and the maximum rate of discount was fixed at twelve per cent.¹

This well-directed scheme of reorganisation fell through and the Bank was started as a Government Bank pure and simple, managed in all its aspects by the servants of the Government. The management rested in the hands of these *ex-officio* financial officers of the Government and, according to Brunyate, "It was managed unsuccessfully by the Government officials during the early days of its career."² Even the Presidency Bank of Madras, started in 1843,

¹ See Public Consultations, 1809, 7th Nov., p. 6726.

ditto. .. 23rd Nov., p. 6727.

² Brunyate must have been referring to Maitland's mismanagement of the Madras Bank in 1829 as a result of which strict regulations were passed in the matter of making loans. See Select Consultations, 5th Oct., 1830, Nos. 1 to 3.

had to suffer on account of incompetent management during the first two years of its existence. "Improper advances to speculative persons formed the chief mistake."

Another industrious writer, Mr. Crawford, says "we have never seen stated in any public document the amount of the capital of the Bank, and its profits instead of being carried half-yearly or yearly to account are permitted to accumulate for a series of years and thus carried to public credit.¹ During 1826-1827 the estimated profit was £620,226 but the real profit was £516,855 if the pagoda was to be valued at its real rate of 6s. 8d. If the rate of profit be 10 per cent. then the capital must be roughly one-fourth m £. The Government of Madras having no surplus revenue the capital must have been secured on the payment of five per cent. interest on deposits in which case the real profits of banking business is only five per cent. This dabbling in deposits and discounts for five per cent. profit on the part of the Government was very adversely censured by Mr. Crawford who considered "it least praiseworthy on the part of the Government to waste precious time in attending to the concerns of a small money-shop."

Whatever amount of truth there might be in the ingenious calculations of Mr. Crawford, we possess another reliable and authoritative estimate of the profits of the Government Bank. This was stated by the Accountant-General in a public document and it is a mistake to suppose, as Crawford has done, that no public document as regards its operations exists. In 1819 a report was published with reference to the bank's past and present business. This report states that the Bank was founded when there was great scarcity of specie, a failure of mercantile credit and considerable public and private distress. As a French invasion was feared the Bank permitted an accumulation of specie in the Treasury for military purposes and the withdrawal from circulation of a large quantity of paper money bearing interest. It proposed to be quite independent of the Government but as a matter of fact it was clearly related to the Government and the scheme of reorganisation fell through. Its business for the Government consisted in purchasing

¹ See Mr. Crawford's Evidence before the Select Committee of the House of Commons, 1830.



bullion for the Mint and managed the remittance business to Bengal. It had no capital of its own. In the very first year its note circulation averaged eight and a half lakhs of pagodas. Thirty-three lakhs worth of paper money bearing interest at eight per cent. was withdrawn. Latterly the Bank had little connection with the Government save for little or small withdrawals of specie from the Treasury.

This Bank was considered "unsuited to the wants of the second Presidency in India" and Mr. J. Ochterlony outlined the scheme for improving the Bank and making it an institution modelled on the Bank of Bengal and the Bank of Bombay. The Madras Chamber of Commerce also took a prominent part in the agitation for the starting of a better Bank. The capital of the new Bank was to be thirty lakhs of rupees of which three lakhs were to be offered to the Government. On 4th July, 1840, the capital was fully subscribed and a memorial was sent to the Court of Directors for a charter of incorporation. The Bank was actually started in 1843 as there was considerable delay in the matter of incorporation due to the request made by the public to reduce the capital to twenty lakhs.¹ The Court of Directors refused to consider this suggestion and considered it dangerous to grant wide privilege of note-issue to an inadequately capitalised bank.²

Though the Government Bank failed to organise mercantile and private credit on suitable lines, it did good service in those days when private banks did not exist to fill the void created by the failure of the earlier European Banks, *viz.*, the Carnatic Bank, the British Bank and the Asiatic Bank. For obtaining a candid estimation of the services of the Government Bank the following quotation from the Madras Gazette would be of great use. "In its days it had been a great accommodation to the public, a safe depositary for unemployed balances and a source from whom the man of principle and integrity

¹ See Financial Consultations, 16th June, 1840, Nos. 9-11.

² Ditto, 29th Nov., 1842, No. 17.

Ditto, 9th May, 1843, Nos. 4 and 5. The Presidency Bank of Madras was started on lines similar to that of the Bank of Bengal. Act IX of 1843 gave the charter of incorporation and the new Bank began its operations in 1843. Mr. S. D. Birch was the first Civilian Secretary. Later on he became connected with the Bank of Bombay which failed in 1866 crisis. See Financial Consultations, 23rd May, 1843, Nos. 17-19; also 27th June, 1843, Nos. 28-30.

has been relieved in a moment of necessity and upon which he has relied with confidence but like many other good things it has suffered from abuse and a system of dealing and procuring accommodation the most injurious to the man of straightforward dealing and conscientious punctuality."¹

The Government Savings Banks.

No other writer has evidently contradicted the description of Cooke as regards the working of the Government Savings Banks in the Presidency Towns—specially that of the City of Calcutta. The credit of starting the Government Savings Banks in the P. Towns in 1833 is usually attributed to Lord William Bentinck, but what really was done by him was only to extend the Government Savings agency of 1810 which was being managed by the Accountant-General and the Sub-Treasurer. Savings Banks were not unknown by this time. One such institution conducted its operations successfully in Serampore.² The failure of the Agency Houses created a void in the money market and there were many people who suffered acutely by their failure. The Government Savings Agency working since 1810 was empowered to extend its activities. By 1855 it was carrying on its transactions with all parts of the country by means of the District Treasuries under the supervision of the Collectors and the Divisional Paymasters. By the Act of XXVI of 1855 the Secretary to the Government Savings Banks was empowered with judicial powers. The Government Savings Banks were nominally under the supervision of the Accountant General to the Government of India but there was a separate establishment under an actuary who had to give both the bond of indemnity and security for the correct discharge of his duties. The usual practice was to create deposits and debit withdrawals made at the District Collectors and Paymaster's Treasuries on monthly returns forwarded by their officers. Repayments were made by the Savings Bank Secretary by orders on Collectors and Paymasters.³ It is recorded that the business of the Savings Bank was transferred to the Bank of Bengal in 1856.⁴ Separate District Savings Banks were not created till 1870.

¹ Quoted by the Asiatic Journal from the Fort St. George Gazette, Sept. 29, 1830.

² See Asiatic Annual Register, 1824, July 8, p. 192.

³ See the Asiatic Journal, March, 1839, p. 198.

⁴ See C. N. Cooke, Banking in India, p. 341. The letter of the Financial Secretary

Since Cooke wrote his description of the Government Savings Banks it is commonly supposed that in 1856 the Bank of Bengal displaced the separate agency under Government orders published in the Calcutta Gazette of 27th January, 1855. It was not the management that was actually transferred. A reference to the proceedings of the Government of India in the Financial Department, dated 22nd August, 1861, would however make it clear that the expediency of transferring the management of the Savings Bank to the Bank of Bengal and the proposed branch banks was considered in 1861. Though this proposal was agreed to by the Secretary of the Bank of Bengal, the Civil Paymasters of Fort St. William and the Accountant-General, the Governor-General decided that the Bank of Bengal was to be utilised merely as the bankers to the G. S. Bank however the management was to continue as before under the Accountant-General and the Actuary. The Bank of Bengal continued as the custodian of the funds of the G. S. Bank in Calcutta till September, 1863, when the management also was handed over to the Bank of Bengal. Formal notice was served in 1886 on the Bank of Bengal that Savings Bank business might be withdrawn at any time on nine months' notice being given to it. Actual notice to the effect was served on the Bank of Bengal in 1895 and Symes Scutt records that it was actually transferred in October, 1896.

The Government Savings Bank in Calcutta became popular from the very early years of its start and this was undoubtedly due to the great preparations and propaganda work done before its actual inception. A special Committee consisting of the following gentlemen was appointed to organise a plan for the Government Savings Bank.¹

Names of the gentlemen who formed the Committee.

P. M. Wynch, Esq., President.

J. A. Dorin, Esq.

C. E. Trevelyan, Esq.

Lieut-Col. Kennedy.

to the Government of India, dated 18th January, 1856, gives the correct information but the separate managing agency was not abolished in 1856. Till 1863 the separate management existed and from September 1863 the Bank of Bengal was paid monthly compensation of Rs. 750 for managing this business. See Symes Scutt, History of the Bank of Bengal, 67.

¹ See the Calcutta Courier, May, 1833.

Capt. H. B. Henderson.

Theodore Dickens.

Babu Ramcomul Sen.

This Committee can be considered as *the first banking committee* appointed in this country and the starting of the Government Savings Bank was recommended by it. Due to the persuasion of the Indian Member of the Committee, Babu Ramcomul Sen—Khazanchee of the Bank of Bengal—even the clerks of the Bank and Government public offices and the pilot service began to deposit their savings. On the very first opening day there were nearly 62 deposits ranging from one Rupee to Rs. four hundred. The total deposits amounted to about Rs. 3,828. The honour of being the first depositor fell to the lot of Baboo Dwarkanath Tagore and his son was the second depositor, each depositing about four hundred rupees mainly to set an example to the rest of the members of the Hindu community. During the first five years, *viz.*, November, 1833 to November, 1838, there were 3,899 depositors, with roughly about twenty-eight and one-fourth lakhs of rupees as deposits. By 1840 its gross operations amounted to 40 lakhs of rupees and about 18 lakhs of rupees were invested through its medium in public funds.¹ The number of accounts exceeded 4,500 in number. The depositors' list included all classes of people. In 1842 the Government undertook the wise step of paying full month's interest on deposits made within the first four working days of the month. In 1854 there was the first reduction of the rate of interest payable on the deposits of the civil classes from 4 to 3 per cent. per annum. The limit of all deposits for all classes was raised from Rs. 500 to Rs. 1,500 and the rate of interest for the deposits of the soldiery was reduced from four to three and three-fourths per cent.

¹ See the Pamphlet "Remarks of the Savings Bank" which was published in 1840 or thereabouts. The anonymous writer of this pamphlet remarks that numerous branch banks of this parent institution be started at such places as Benares, Dacca, Patna, Allahabad, Cawnpore, Mirzapore, Saugor, Jubblepore, Agra, Delhi, Bareilly, Furrackabad, Meerut, Ludhiana, Kurnaul, Saharanpore, Almorah and Simla and other big towns. They would be secure places of deposit, afford inducement to industry, act as accumulators of capital, tend towards increased productiveness of labour and give increased facility for providing for physical wants to the depositors. A copy of this pamphlet exists in the Imperial Library and from internal evidence it can be gathered that Hon'ble F. Shore, the writer of two volumes entitled "Notes on India" might have been the probable author of this pamphlet also.

It speaks volumes in favour of the first Committee of management which regulated the business and modified the original rules in the light of actual experience gained during the course of the management of the first few years. As a repetition of the original rules guiding the business of the Bank would occupy too much space, only a brief mention of the salutary measures leading to its actual success would be made.¹ The Bank was placed under Government responsibility and it was open to all classes of people without distinction. The Government reserved the power to raise or lower the rate of interest after six months' notice in the Calcutta Gazette. When the deposits of a depositor were to amount to Rs. 500 they were to be transferred to four per cent. Government Loan on behalf of the depositor. Thus the habit of investment in Government securities was also to be taught to these small savers. Thus the enforcement of such sound regulations which exist even to the modern day in one modified form or other, must be held responsible for the success of the Government Savings Bank. It was the laxity of management and absence of such rigid rules that were chiefly responsible for the failure of the Bengal Military Bank which was a Savings Bank mainly intended for the military classes. This leads us on to the subject of the Bengal Military Bank whose general plan of work is outlined in the Selections of the Calcutta Gazette. But no other writer on Indian Banking has referred to its work and the reasons for its failure. It is for the first time these details of their operations are collected from the contemporary newspapers and magazines.

The Bengal Military Bank.

The plan of the Bengal Military Bank was first devised by the Commander-in-Chief and after securing the approval of the Governor-General in Council, Bengal Military Bank was started mainly for the purpose of enabling the Military Officers to remit their monthly savings and to assist the Regimental Savings Banks which were in existence in Bengal by that time and to help the formation of several more Regimental Savings Banks by affording them proper means of investing their funds with security.

¹ See the Calcutta Gazette, October 12th, 1833. 6

The Work of the Bank.

The Bengal Military Bank was authorised to receive deposits from 1st January, 1821 from all Military Officers, Commissioned or Non-Commissioned or Warrant Officers or any other officers attached to the Military service of the East India Company. The deposits (not less than ten Sicca¹ Rupees) could be made out of their pay or monthly allowances by sending an application to the Pay-Master authorising him to deduct the stated sum from their pay. The form of application was as follows :—

Deduct from this pay-bill and remit to the Military Bank as follows :

For Captain...	...	...	One Hundred Sicca	Rs. 100
„ Lieutenant	...	...	Fifty Sicca	Rs. 50
„ Serjeant	...	...	Ten Sicca	Rs. 10
TOTAL				Sicca Rs. 160

Signature of the Captain.

The Pay-Master had to remit this sum to the Secretary of the Bengal Military Bank stationed in Calcutta by a bill of exchange on the Accountant-General drawn in favour of the Bank.² A detailed statement was also to be sent to the Accountant General and the Memorandum was to state in full the details, *viz.*, amount of deduction from the pay, Battalion Regiment, for the month of year..... to be remitted to the Bengal Military Bank. In addition to this deduction from pay individual depositors could remit savings directly to the Secretary of the Bank.

¹ The Sicca rupee became the standard money in Bengal by that time. It must be remembered that there were other denominations of Rupees current in Bengal and Lord Cornwallis made a great effort to standardise the 19th Sun Sicca Re. as the unit of account in Bengal. By 1795 it was established as the standard money of Bengal. See the Selections from the Calcutta Gazette which reproduce the Government Notification on this subject ; Fort William Public Department, October 24th, 1799. The intrinsic value of the different species of rupees current in Bengal Behar and Orissa compared with the Sicca Re from essays made in Bengal is quoted in a tabular form in the Notification.

² See the Bengal Harkary, May 7th, 1835, quoted by the Asiatic Journal.

Management of the Funds.

The General Military Bank in Calcutta was to lend these funds to the best advantage on the pledge on deposit of Government paper, public bank shares and other good securities so as to realise the highest rate of interest consistent with perfect safety.

Officers of the Bank.

Twelve directors were to be in charge of its operations. The Government had the right to nominate three out of twelve and the remaining were to be elected by the constituents of the Bank at the annual meeting to be held in the month of January. The *ex-officio* Government Directors were (a) the Adjutant-General of the Army; (b) the Military Auditor-General; (c) the Accountant, Military Department. The first batch of directors for the year 1821 was nominated by the Government. The first directors were the following:—

1. Colonel J. Nicholls, C. B., Quarter-Master General, His Majesty's Forces.
2. Lieutenant-Colonel J. Paton, Quarter-Master General of the Army.
3. Major L. Wiggins, Assistant Military Auditor-General.
4. Major C. H. Campbell, Deputy Secretary to the Government, Military Department.
5. Captain R. H. Sneyd, 1st Regiment of Cavalry—Adjutant.
6. Captain W. S. Beatson, Assistant-Adjutant General of the Army.

Besides these military officers expert banker-merchants and partners of the Agency Houses and a Civilian officer were recommended to the Board of Directors.

7. John Palmer, Esq.
8. George Cruttenden, Esq.
9. James Young, Esq.

Mr. Ballard of the firm of Messrs. Alexander and Company was appointed as the Honorary Secretary and was authorised to appoint House Treasurers to the Bank.

Regulations for Office Business.

The following were some of the most important regulations or by-laws of its business.

1. The Treasurers have to keep the Bank accounts in a separate set of books which would have to be produced at the time of the meetings of the Directors or at any time.

2. By the 5th of every month the Secretary has to furnish the receipts and disbursements and suggest the best methods for investing the floating balances.

3. All bonds, deeds, mortgages or other papers and documents having reference to pecuniary transactions and being bank stock or securities are to be made out in the names of the directors ; but mere receipts may be signed by the Secretary for the Treasurers.

4. There shall be quarterly meetings of the directors for inspecting the accounts and such other business as may be brought before the Board. Special meetings when required for urgent business may be summoned by the president or any other directors.

5. Signatures of three directors was considered adequate to sanction any measure and to authenticate any account.

6. The Office of the President was to be annual and three directors had to go out annually by rotation. The directors were to select the President and the three seats to be vacated annually were to be filled up by the votes of depositors.

The most important thing to be noticed is the fact that the bye-laws do not give any loop-hole to the officers to mismanage the funds. They were also framed with the view of expediting business on sound lines and the permission for the depositors to elect three directors annually was evidently in the interests of securing the continuity of policy so eminently desirable in the case of all savings banks.

Rules for Depositors.

The following were some of the salutary provisions with reference to depositor's business:—

1. Remittance must be made in sicca rupees. Each remittance must be for a minimum figure of ten sicca rupees and should not contain any fraction of a rupee.

2. Bills drawn by depositors not in excess of actual deposit will be honoured at any time. But to facilitate business bills will be payable only at two fixed periods, viz., 15th January, and 15th July. Officers going on leave will be allowed to draw any portion of their deposits by bills at ten days' sight.

3. The aggregate deposits are to be treated as joint-stock and vested in Government securities. Profits arising out of this will be divided among shareholders according to their respective proportion and carried to the credit of their accounts.

4. Half-yearly drafts of the shareholders below 1,000 sicca rupees will be paid in cash ; if greater than that, it is left to the option of the Directors to pay it by transferring a portion of the stock at the rate at which it was purchased or at the rate of the day or at par as may appear most equitable.

A perusal of the above rules will make it clear that they were well-conceived and it is a wonder why this bank failed in spite of wise bye-laws and regulations framed in the interests of the depositors.

Actual Operations.

By the end of 1833 there were 402 accounts of depositors and the assets of the bank amounted to Rs. 6,20,540, all of which, excepting a floating cash balance of Rs. 11,320-14-7 deposited in the Bank of Hindostan, was represented by mortgages of house property. But as mortgages depreciated—specially that on the house of Sheikh Abdulla—a loss of one-sixth of the loan had to be covered from the depositors' account by transfer to a special account in 1830 being then estimated at about Rs. 1 60,000. In 1833 about two lakhs had to be struck off and another half-lakh as other mortgages depreciated. This reduced the value to Rs. 3,75,000. From this sum again about Rs. 75,000 had to be deposited to pay arrears of dividend to depositors. So three lakhs remained to be divided among all the depositors whose claims amounted to 10 lakhs of rupees.

Reasons for Failure.

The main loss to the Bank was solely due to depreciation of the house property and the sad mistake committed by the Bank in

preferring this type of security to all others. There was an entire sacrifice of the principle of the spreading of investments of the Banks. The depositors congratulated themselves on their good fortune for not having lost their entire property which fate befell all the depositors of the Agency Houses which failed just at that time. Even if we refer to contemporary history of the Savings Banks of the United Kingdom we meet with similar failures of these institutions. Many of these started in the early years of the Nineteenth Century from 1817-1841, failed as a result of a series of frauds in the management which swallowed a quarter of a million of the hard-earned savings of the poor. The first postal savings bank was opened only in September, 1861, as a result of Mr. Gladstone's efforts in this direction.

The expenses of the Bank amounted to roughly Rs. 150 a month. There was thus no sacrifice of the sound canon of economy in the management of the banking institution.

Although the Government appointed three *ex-officio* directors to help the Board in the management of the business, yet there was no other responsibility on the part of the Government arising out of the failure of the mortgages. The Government directors were indeed negligent in the matter of not insisting upon a prompt recall of all loans as soon as they realised the depreciation of the mortgaged property. They also tolerated the laxity of the officers in the respect of collecting all arrears in the matter of interest on the part of the defaulting borrowers. There was no attempt at foreclosing the mortgages and selling the property. The Government itself never communicated the fact of mismanagement to the depositors. From a contemporary paper of this period it can be gathered that the Government originally intended to inform the depositors that there was no Government security behind the institution, but this was not communicated even though it knew or had an inkling of the mismanagement of the B. M. Bank. One of the directors, Captain Rawlins, suggested to the depositors the possibility of bringing a civil suit against the Government for this mismanagement. Two leading barristers were consulted on this point of Government responsibility. On their advice the suggestion of instituting legal proceedings against the Government was ultimately dropped. Most of the aggrieved depositors belonging to the 38th Regiment, private as well non-commissioned officers sent in a monster petition to the Government praying

for mercy and refund of money. But nothing came out of this appeal.

The next mention of the B. Military Bank is made on 20th May 1835, when it was stated that 60 per cent. of the deposit money was paid to the depositors. The last mention of the B. M. Bank was made in 1838, March, when there was a further declaration of dividend of five per cent. It was also decided that the "remaining properties were to be put to auction early next month and it was expected that the proceeds will realise sufficient to give the depositors a further dividend of twenty per cent. making a total dividend, say, of 12 annas in the Rupee."¹

The history of the Bombay Military Bank² is an uneventful one. It was started in July 1829, and as soon as the Government Savings Bank was instituted in May, 1835, the Bombay Government soon closed the B. Military Bank and gave the option to the depositors to transfer the account, including the interest, to the Government Savings Bank or withdrawing it altogether as all interest would be discontinued from 1st May, 1839.³ Lack of space forbids me to outline the work of the Madras Military Bank.⁴

The Nature of the Military Banks.

An attempt has been made to describe the methods and procedure of the Military Banks. From the above description it is apparent that they were no commercial banks issuing notes or post-bills intended for the accommodation of gentlemen living at, or going to, other settlements than Calcutta. They did no regular banking business nor purchase bullion. They did not receive deposits to be repayable at sight. Thus it appears that they were pure savings banks intended to promote savings on the part of the military officers

¹ See the Asiatic Journal, 1858, March.

² For a detailed statement of the operations of the Bombay Military Fund (1836-1837), see the Asiatic Journal, 1838. This must not be confused with the Military Savings Bank of Bombay, the details of whose operations will be published in my forthcoming work entitled "Organised Banking in the Day of John Company."

³ See the Government Notification, dated 11th March, 1839, of the Bombay Castle, quoted in the Asiatic Journal, June, 1839, p. 147.

⁴ For further details see the Madras Manual of Administration, 1896, Vol. I.

under the service of the East India Company. They resemble closely the modern philanthropic or trustee savings banks. It was the result of the attempt on the part of the Government to improve the economic condition of the military classes. All the earnings after deducting the necessary expenses were to be divided among the shareholders in the form of interest which is to be credited to their accounts. The Government directors can be compared to the trustees who operate the modern trustee savings banks without taking any remuneration. Just as the modern trustee savings banks are safeguarded from unexpected calls on the part of the depositors, so also the B. M. Bank established the convention of paying the drafts of the depositors half-yearly. The Banks were thus quite simple in character and confined themselves primarily to the business of collecting money and investment of the same without any risk. Thus their main business was to transfer capital and the manufacture of bank money was not their object. They had only the aim of redistributing capital amongst the points of highest yield but yet safe at the same time. The economy yielded by the Banks was the safety of funds placed in their hands. They must also be considered as the legitimate forerunners of the Government Savings Banks which were later on established in the Presidency Towns between 1833 and 1835.

The correct and complete list of banks of this period started either by the Government or by the European settlers in this country would be as follows:—

Col. 1. Name of the Bank.	Col. 2. Date of formation.	Col. 3. Branches.	Col. 4. Head Office.	Col. 5. Date of closing.	Col. 6. Remarks.
(1) The First Government Bank of Madras.	1683	Nil	Madras	Not known	Bank of deposit alone.
(2) The First Government Bank of Bombay.	1720	"	Bombay	Must have been closed in 1784. It was in existence in 1783.	Remodelled as a Bank of Issue.
(3) The Bank of Hindostan	1770	"	Calcutta	Failed in the awful crisis of 1831.	Symes Scutt mentions the fact of its reorganisation and its failure in 1866. He does not mention the sources of his information, nor publish any details of reorganisation.
(4) The General Bank (Government Bank of Warren Hastings).	1773	Hugli, Nadia, Jessore, Burdwan, Midnapore, Birbhum, Bishnupur, Murshidabad, Pachiti, Dacca, Rajmahal, Dinajpore, Purnea, Rungpur and Bhagalpore	Calcutta	Closed in 1775	No failure of the Bank but owing to opposition in the Council it had to be closed.
(5) The Bengal Bank	Exact year not known — in existence by 1784.	Nil	Calcutta	Failed in 1891	Stringency due to Warfinancing in the Calcutta Money Market might have led to its failure.
(6) The General Bank of India.	1785	"	Calcutta	Failed in 1791	Wound up according to terms of organisation. It was not reorganised as Cooke suggests. The very bank building was sold in 1791. See Carey, Annals of Hon'ble John Company.
(7) The Carnatic Bank	1788		Madras	Exact date not known	Might have failed as a result of the competition of the Government Bank organised in 1805.

Col. 1. Name of the Bank.	Col. 2. Date of formation.	Col. 3. Branches.	Col. 4. Head Office.	Col. 5. Date of closing.	Col. 6. Remarks.
(8) The British Bank	Exact date not known — in existence in 1795.	Nil	Madras	Exact date not known	Might have failed as a result of the competition of the Government Bank organised in 1805.
(9) The Asiatic Bank	Ditto	"	Madras	Ditto	Ditto.
(10) The Second Government Bank of Madras.	1805	"	Madras	Wound up or reorganised as the Presidency Bank.	No failure but reorganised as a result of public agitation to have a more useful Bank.
(11) The Bank of Calcutta	1806	"	Calcutta	Rechristened as the Bank of Bengal.	No failure but on receiving the Charter in 1809 the Government Bank, as it was called, became the Bank of Bengal.
(12) The Bank of Bengal	1809	No branches excepting agencies till 1861.	Calcutta	Amalgamated with the other Presy. Banks.	No failure but as a result of amalgamation it has become the present Imperial Bank of India.
(13) The Commercial Bank.	1819	Nil	Calcutta	Exact date not known	Being started by the Agency House it must have shared its fortunes. It was wound up in 1828 to give place to the Union Bank of Calcutta started in 1828.
(14) The Bengal Military Bank.	1821	"	Calcutta	Wound up in 1836	Failed as a result of depreciation of investment of real estate and house property.
(15) The Calcutta Bank	1824	"	Calcutta	Wound up to give place to the Union Bank.	On the ashes of the Agency Houses rose the Union Bank and the other banks wound up their business to give place to the reorganised institution.

(16) The Bank of India	1828	Nil	Calcutta	Failed in 1823	It could make no headway in the market as the organisers had no solid backing to support them in their endeavour.
(17) The Military Bank of Bombay.	1829	"	Bombay	Wound up in 1839	It was amalgamated with the Government Savings Bank in Bombay.
(18) The Madras Military Bank.	...	"	Madras	...	...
(19) The Union Bank	1829	Singapore and Mirzapore	Calcutta	Failed in 1848	For a decade it competed successfully with the Bank of Bengal but mismanagement after 1839 led to failure.
(20) The Agra and United Service Bank.	1833	Calcutta, Bombay, Madras, London, Lahore, Canton.	Originally at Agra, soon transferred to Calcutta.	Wound up in 1894	Symes Scutt says that it failed in 1900.
(21) The Government Savings Banks.	1833	"	Presidency Towns.	Taken up by the Government Post Office.	No failure but management changed hands in 1896 from that of the Bank of Bengal into the hands of the Government Post Office.
(22) The Bank of Mirzapore	1835	" Nil	Mirzapore	Failed in 1836	Clear proof of the fact that the people in the interior could not appreciate the services of banks.
(23) The North-Western Bank of India.	1840	London, Calcutta, Bombay, Delhi, Cawnpore, Simla, Mussorie.	Originally at Mussorie then transferred to Calcutta.	Liquidated in 1859	The bank can be considered a typical example of bank mismanagement.

Col. 1. Name of the Bank.	Col. 2. Date of formation.	Col. 3. Branches.	Col. 4. Head Office.	Col. 5. Date of closing.	Col. 6. Remarks.
(24) The Bank of Bombay	1840	No branches till 1862	Bombay	Amalgmated with the other Presy. Banks.	It has become a part of the Imperial Bank of India.
(25) The Bank of Ceylon	1840	Agencies at Calcutta, Madras and Bombay. Branch in Kandy.	Colombo	The Bank amalgamated with the Oriental Bank of London in 1849.	As a result of amalgamation the reconstituted unit came to be known as the Oriental Banking Corporation.
(26) The Bank of Western India.	1842	Colombo, Calcutta, Hong-Kong and Singapore.	Bombay, re-moved to London, 1846.	Did not fail	To secure the privileges of 1845 Act of the United Kingdom it removed its head office to London and became the Oriental Bank in 1846.
(27) The Agra Savings Fund	1843	Nil	Agra	Date of closing not known	It might be that with the advent of Government Post Office Savings Bank it might have lost its business.
(28) The Bank of Madras	1843	No branches before 1860	Madras	Amalgamated with the other Presy. Banks	It forms part of the present Imperial Bank of India.
(29) The Delhi Banking Corporation.	1st October, 1844. Incorporated in 1860.	London, Calcutta, Bombay, Allahabad, Lucknow, Mussoorie and Madras.	Delhi	Exact date of failure not known.	As a result of the successful working of the Alliance Bank of Simla this bank might have lost its business.
(30) The Simla and Umbella Bank.	1st November, 1844.	Umbella	Simla	Failed in 1893	As a result of its failure the void could be easily filled up by the progressive Alliance Bank.
(31) The Cawnpore Bank	1st May, 1845	No branches	Cawnpore	Failed in 1851	This bank can be considered as an inglorious example of bank mismanagement so common at that time.

(32) The Benares Bank	1st August, 1845.	No branches	Benares	Failed in 1850	This bank should not be mistaken for the present Bank of Benares. Another splendid example of incompetent management.
(33) The Oriental Bank	1846	Board of Directors in Bombay; branches at Calcutta and Colombo.	London	Amalgamated with the Bank of Ceylon in 1849.	In order to secure note-issue this amalgamation was carried out.
(34) The Commercial Bank of India.	1845	Calcutta, London, Canton and Shanghai.	Bombay	Failed in 1866	It took active part in speculation which was so rife in Bombay at that time.
(35) The Dacca Bank	1846	Nil	Dacca	Amalgamated with the Bank of Bengal in 1862.	It had purely restricted business.
(36) The Comptoir d'Escompte of Paris.	1848	Branches in Calcutta, Bombay, Madras and Pondicherry.	Paris	Still working	The first strong foreign Exchange Bank to enter into this country. It opened its Indian branches in 1860.
(37) The Oriental Banking Corporation.	1851	Branches established in Scotland, Mauritius, Melbourne, Sydney and Galle.	London	Failed in May, 1884.	Received Royal Charter in 1851.
(38) The Chartered Bank of Asia.	1852	No branches	London	Dissolved in November, 1856.	The Colonial Office did not favour it with a Charter to its own liking when it suggested amalgamation with another Bank.
(39) The Chartered Bank of India, Australia and China.	1853	Calcutta, Bombay, Rangoon, Singapore, Hong-kong and Shanghai.	London	Still working	.....
(40) The Mercantile Bank of India, London and China.	1853	Branches in Ceylon, Colombo and Candy. Agencies at Canton, London, Shanghai and Calcutta.	London	Wound up in 1857.	It was amalgamated with the Chartered Bank of Asia to form the Mercantile Bank of India, London and China.

Col. 1. Name of the Bank.	Col. 2. Date of formation.	Col. 3. Branches.	Col. 4. Head Office.	Col. 5. Date of closing.	Col. 6. Remarks.
(41) The London and Eastern Banking Corporation.	1854	Calcutta and Bombay	London	Failed in 1857	...
(42) The Chartered and Mercantile Bank of India, London and China.	1853	London, Calcutta Madras, Singapore Colombo, Shanghai, Kandy, Mauritius, Penang, London, Canton.	Bombay	Wound up in 1892.	The assets and liabilities were handed over to the Mercantile Bank of India, Ltd., 1892.
(43) The Central Bank of Western India.	November, 1860.	Calcutta	Bombay	Amalgamated with the Bank of Hindostan, China and Japan.	...
(44) The Uncovenanted Service Bank.	1846	No branches	Agra	The Uncovenanted Service Bank was wound up about 1894.	...

It must not however be supposed that this list is an exhaustive one. All that can be claimed for it is that it is more exhaustive than that of the other lists mentioned in the early beginning of the chapter. The writer has come across various statements made by authoritative people of the attempts made to start banks in the interior. Messrs. Alexander & Co., which founded the Bank of Hindostan in 1770 in Calcutta also strove to start a similar institution in the interior. One Mr. Ballard, a medical man of considerable skill, was entrusted with the banking business of the bank started at Bhauleah. It did not succeed and had to be given up.¹ Similarly an attempt was made on the Bombay side in the first half of the Eighteenth Century by the Dutch people to start a bank. Apart from the fact that it worked for a few years no details are forthcoming. It must also be realised that this list does not include a large number of banks which were started as soon as the limited liability principle was accepted in 1861 and 1862. The Punjab Bank, Ltd., The Sind, Punjab and Delhi Banking Corporation, Ltd., the Peoples' Bank of India, Ltd., and the Bank of Rohilkhand were organised during these years, 1861 and 1862. All these banks are enumerated by C. N. Cooke in his Banking in India but they lie outside the scope of this chapter.

The Agency Houses.

Some information has to be given of the Agency Houses conducting semi-banking business along with trading and agency work. They were not merely bankers attracting deposits and granting loans but "European shop-keepers, planters, ship-owners, proprietors of breweries, tanneries, distilleries, cotton, flour, and saw-mills." It is not wise to put them out of category of financial intermediaries of this period for in those days when the European banks were few and few Europeans were allowed to settle in the country it is these that conducted semi-banking business and founded pure banks to deal in a more comprehensive manner with the banking needs of the population. It is tolerably clear then that an account of their operations should be given as they were the pioneers of the banking trade in this country.

¹ See Holt Mackenzie's evidence before the Select Committee of the House of Commons, March, 1832; Qns. 133 to 137.

Crawford says that the Agency Houses had originally no capital of their own and they depended on the great annual savings of the Company's servants.¹ This can be corroborated by another statement of an equally competent observer who says that "the Agency Houses were started chiefly of gentlemen who had been in the Civil and Military services who finding their habits better adapted for commercial pursuits obtained permission to resign their situations and engage in agency and mercantile business. They received the accumulations of their friends in the Company's service. They lent them to others or employed them themselves for purposes of commerce. They were in fact the distributors of capital rather than the possessors of it. They made their profit in the usual course of trade and by difference of interest in lending and borrowing money and by commission. In course of time carrying on successful commerce many became the possessors of large capital and returned to England. The Agency Houses became the usual depository of a great portion of the savings and accumulations of the civil and military services in India."

Although it was the above quotation alone that recent writers have been making use of not one of them has given an idea of their real operations. More detailed information is available in the newspapers and magazines of that time. These describe not only the operations of these Agency Houses but try to place before the readers an idea of the economic environment of this particular period. It was not the Company's servants in Bengal alone that were the sole depositors of their savings in the hands of the Calcutta Agency Houses. The officers of the Madras and Bombay Provinces remitted their savings to the Agency Houses at Calcutta. The natives of Calcutta also deposited their savings in their hands, for roughly ten per cent. was granted on these deposits. As the Government funds,² i.e., new loans, did not pay this high rate and as this rate of interest fell from ten to five per cent., the deposits of the Agency Houses must have increased.

¹ See J. Crawford, *Sketch of the Commercial Resources and Monetary and Mercantile System of British India*, 1857.

² See the Evidence of T. Bracken before the Select Committee of the House of Commons, March, 1832.

³ See Hon'ble F. J. Shore, *Notes on India*.

The money secured in this way was loaned out to people engaged in indigo business, silk or opium and cotton. Their *modus operandi* can be easily gathered by noting the way in which they helped the indigo planters. Their transactions with the indigo planters can be considered as typical of their operations. Twelve per cent. was the rate at which money was usually loaned out to them. It could not have been higher than that for the legal rate of interest could not rise above twelve per cent. But several other charges were however added, *viz.*, a charge of one per cent. for receipts and disbursements. Money was advanced to the planter monthly as subsistence allowance or money and petty charges were made on this amount. The produce had to be sent to the money-lending agent and the borrower had to pay commission for receiving and disposing of it. Altogether the rate they had to pay was about 18 per cent. or 20 per cent. on the borrowed money. Even in the matter of loans to civil and military officers the proceedings were of the same character. Twelve per cent. was the legal rate that could be charged but charges had to be paid for receipts and disbursements. The borrowers had to insure their lives and for this the annual charges made amounted to the premium. Even this premium they never paid to the Life Insurance Office preferring to take the risk themselves, so that it was only a trick to raise the interest rate a little higher. This was how they always avoided the usury laws of the time.

It was not the ancillary banking business that has made them famous. Like the indigenous bankers of the time they attracted deposits and lent them. But these financial activities were overshadowed by those of the merchants, middlemen, brokers and industrialists. The partners of these firms could afford to live in "princely fashion" and in "the highest style of luxury." Notwithstanding this lavish expenditure they often returned home with the most princely fortunes.¹ They could afford to become "the mercantile

¹ Of the dividends paid by the older Agency Houses an idea can be gained by a perusal of the following dividends declared by them :—

Name of the Agency Houses.	Rate of the Dividend paid.
Palmer & Co.	... Thirty per cent.
G. Mackilop & Co.	... Twenty-six per cent.
Alexander & Co.	... Six per cent.
Fergusson & Co.	... Thirty-six and half per cent.
Mackintosh & Co.	... Fourteen per cent.
Colvin & Co.	... Twenty-nine and half per cent.

See the Calcutta Review, January-June, 1847, pp. 163-189.

Leviathans of the East." They combined in their hands the part of several characters in addition to the role of bankers. They were bankers, ship-owners, merchants, and agents and possessed a complete "monopoly" of the whole of the foreign and internal trade of the country which was then about six times as large as the British Isles."

Their Number.

As to the exact number of the earlier Agency Houses nothing definite can be stated. But Hon'ble F. J. Shore says that "six or seven of these Agency Houses stood conspicuous in the City of Palaces." Crawford, writing in 1837, gives us a list of the firms at the different trading centres. But several of them might have been created after 1813. With the opening of trade with India by the 1813 Charter Act the English merchants could send their own agents "who had moderate ideas and moderate salaries." It was the serious competition of these new houses that must be reckoned as the chief cause of the failure of the older Agency Houses which still continued to live in "an aristocratic fashion without contracting their speculative dealings, reducing their establishments and retrenching their personal expenses."¹ They continued their mercantile speculations as before in the same old style investing freely in houses in Calcutta, indigo works, coal mines, ships, coffee, and spice plantations, clearing desert islands as proprietors of land and working cotton, silk and flour mills. By 1825 their position became very risky so that a competent observer, Mr. Trotter, suggested the formation of new Agency Houses in place of the defective old Agency Houses.² Nothing came out of his suggestion.

Cause for their Failure.

The immediate cause for their failure was the withdrawing of money by their constituents on the pretext of sending remittance to Europe. After the failure of Palmer & Co., this became insistent and the Agency Houses borrowed by pledging property to satisfy the

¹ See J. W. MacLellan's article on Banking in India, *Banker's Magazine*, 1893, pp. 50-58.

² See the *Asiatic Journal*, Dec., 1825, p. 617.

banking constituents' withdrawals. Their correspondents in England generally failed to honour their bills drawn on them by the Agency Houses and when this credit was refused they lost all banking business.

The Magnitude of the Catastrophe.

Messrs. Palmer & Co., was the first Company to fail and in spite of state support they could not withstand the shock. This failed in 1830 and the rest of the "princely mercantile houses" followed suit. It was Mr. Palmer of this Palmer & Co., who was styled "the Prince of the Calcutta Merchants" and earned for himself a statue or bust in the Calcutta Town Hall. Its bankruptcy was followed by Alexander & Co., Cruttenden & Co., and others. The general ruin that befell the depositors of the city was almost unparalleled.¹ It caused unheard of ruin to widows and pensioners who had embarked their all in these houses depending with confidence on the security of baits held out such as large interest for money invested in their firms. The effect of the ruin of the Agency Houses did not fall mostly on the partners of the Agency Houses for "most of them realising the storm coming ahead returned home with fortunes leaving penniless adventurers to take their place in the fallen Agency Houses." Macaulay who landed in India just after the failure of the Agency Houses refers to the monetary stringency in the money market and its effect on the style of living of the Company's officers.

¹ Compare Crawford's estimate with that given in the Calcutta Review. It is Crawford's estimate that is quoted by C. N. Cooke, p. 348.

CHAPTER VI

THE INDIAN JOINT-STOCK BANKS.

Early history of joint-stock banking—Agency Houses pioneering banking business—Joint-Stock banks of N. W. Province—The Sepoy Mutiny—Exchange Banks—The beginning of joint-stock banking under Indian management—Its gradual extension—The locale of these banks—The business of the Indian Jt.-St. Banks—Some statistical facts and their interpretation—The Big Four of the Indian money market—Bank failures—Banking crisis of 1913-15—Causes for the widespread failures of banks—Recent bank failures—Suggestions for improving the business of the major Ind. Jt.-St. Banks—Suggestions for improving the work of the smaller banks.

Early History of Joint-Stock Banking.

Indian joint-stock banking is barely a century old. The principles of joint-stock banking were first introduced into this country by the Agency Houses some of which conducted "mixed" banking business. Their primary concern was trade. Of the nature of their business something has been recorded already. Mr. Thomas Bracken, a partner in the house of Alexander and Co., while giving evidence before the Select Committee of the House of Commons relates the history of the Agency Houses thus:—"The Agency Houses were chiefly formed of gentlemen who had been in the civil and military services, who finding their habits better adapted for commercial pursuits obtained permission to resign their situations and engage in agency and mercantile business. They received the accumulations of their friends in the Company's service. They lent them to others or employed them themselves for purposes of commerce, they were in fact the distributors of capital rather than the possessors of it. They made their profits in the usual course of trade and by difference of interest in lending and borrowing money and by commission. In course of time carrying on successful commerce many became possessors of large capital and returned to England. The Agency Houses became the usual depository of a great portion of the

savings and accumulations of the civil and military services in India." ¹

Agency Houses pioneering Banking Business.

Not all the Agency Houses carried on the banking business but only a few, and the Bank of Hindostan which was formed by Alexander and Co., in 1770, had the right to issue bank notes.² But a great many of them performed the three functions of (1) receiving deposits, (2) paying drafts, (3) discounting bills. The real impetus to the starting of banks was given in the year 1813, when an Act was passed removing the restrictions on Europeans settling in India. Several banks were started and during the troublous years, 1829-1833, many of the Agency Houses failed. There was "gross mismanagement, wild speculation, and extravagant living" on the part of these big merchant princes managing the Agency Houses. The other reasons for their failure are already related in a previous chapter.

The Union Bank of Calcutta and the Agra and United Service Bank which arose out of the ruins of the Agency Houses met with temporary success but the former bank had to close its doors in 1848. The first Bank of Benares also failed ignominiously owing to fraudulent and criminal mismanagement on the part of its officers.³

Joint-Stock Banks of the N. W. Province.

Undaunted by these failures new banks were started in the North-West province. An idea of their operations can be had by a close perusal of Mr. Allen's Minute on Joint-Stock Banking in the North-West Province. But the banks of this period could not develop their business satisfactorily. They could encroach on the exchange business till 1833, as the East India Company regarded dealings in exchange as their exclusive monopoly. Though the Charter of 1833

¹ See the Select Committee of the House of Commons, March 24, 1832, p. 151.

² Of the note-issuing operations of the early Banks more information would be forthcoming in my monograph on 'Organised Banking in the Days of John Company.'

³ See C. N. Cooke, Rise and Progress of Banking in India, p. 236.

deprived the East India Company of its trading monopoly and converted the body of merchant princes into territorial magnates, yet the traditional attitude of hostility stood in the way of their growth. Although these Banks had their privilege of note-issue almost unfettered, their issues were small.

The Sepoy Mutiny.

The Great Sepoy Mutiny of 1857 unsettled the country for quite a long time and no banks could arise. But in Bombay, thanks to Lancashire money that poured in for our raw cotton, banks arose during 1864-66. These could not withstand the speculative tendencies of the time and fared miserably. Even the Presidency Bank of Bombay fared no better and had to close its doors in 1866.

The Exchange Banks.

At about this time some of the exchange banks were started in London to conduct banking business in India and with the exception of these no big Indian Joint-Stock Banks were floated. The Allahabad Bank was opened in 1865. Hardly was quiet restored in this country when the exchange trouble began to cause serious loss and the attention of all people, even that of the Government, had to be turned towards this pressing problem. Thus in the 19th century there could hardly be any serious scope for the advance and real development of banking business in India.

The history of the major Indian Joint-Stock Banks for which *Indians* have been responsible begins from the year 1881, when the Oudh Commercial Bank was founded. The Punjab National Bank was established in 1894. The Peoples' Bank was founded in 1901. The Amritsar Bank was started in 1904. It was in the first decade of this century that a serious impetus was given by the "Swadeshi" movement to the starting of indigenous Joint-Stock Banks. The prosperity of North-Western India increased on account of the opening of the canal colonies and the development of export trade in wheat rendered possible the investment of capital in banking companies.

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Its Gradual Extension.

Many large and small banks were established all over the country. But these banks were merely considered as instruments by which the people could become rich all of a sudden. But their disillusionment came during the crisis of 1913-1915 when almost every one of these mushroom banks was severely put to a test.

Name of the Bank.	Head office.	Date of Registration.	Paid-up Capital (Lakhs of Rs.)	Deposits (Lakhs of Rs.)	Branches.
The Bank of India ...	Bombay	1906	100	1'019	3
The Indian Specie Bank. ¹	..	..	75	270	...
The Indian Bank ...	Madras	1907	12	99	4
The Bengal National Bank. ¹	Calcutta	..	8	81	4
The Punjab and Sind Bank.	Amritsar	1908	4	84	...
The Bharat National Bank.	Delhi	..	2	7	...
The Bank of Northern India. ¹	Rawalpindi	..	1	6	5
The Bank of Baroda ...	Baroda	..	30	533	...
The Bombay Merchants' Bank.	Bombay	1909	10	2	...
The Credit Bank of India. ¹	..	1909	19	51	...
The Ahmedabad Banking Corporation. ¹	Ahmedabad	1910	7	23	...
The Central Bank of India.	Bombay	1911	163	1,396	...
The Standard Bank ¹ ...	..	1912	10	...	...
The National Financing and Commission Corporation.	..	1912	11	36	1
The Bank of Mysore ...	Bangalore	1913	20	130	7

¹ These Banks have gone into liquidation.

All these banks were started during the "Swadeshi" boom days and the stimulus arising out of the Partition of Bengal. Some of these Banks have gone into liquidation but others are still working successfully to the present day.

The Locale of these Banks.

At present the Indian Joint-Stock Banks are to be found mostly distributed in the Punjab, the United Provinces, and Madras and in the three Presidency towns of Calcutta, Bombay and Madras. Rangoon, Karachi, Lahore and Cawnpore have a great number of Banks and a clearing house exists in the seven abovementioned places. There are very few Joint-Stock Banks in several of the Native States with the exception of Mysore and Travancore. But the Banks of Mysore and Baroda are doing creditable service in providing banking facilities for the people of these Native States. Modern banking facilities exist in 250 towns out of a total of 700 urban areas possessing 10,000 people and upwards. There are roughly 700,000 places with less than 10,000 people and these have no modern Joint-Stock banks.

The Business of these Banks.

Generally speaking these Banks have two functions before them: (a) to develop the money power of the people and (b) to provide credit for the various sections of the community. Thus their main business is to attract deposits of all kinds—current, fixed and savings.¹ They finance trade by advancing monies, opening cash credits and discounting local or inland bills of exchange. These Banks prefer to lend on bearer securities which are quoted on the local Stock Exchanges and in areas where such are not easily available advances are made on piece-goods, other manufactured articles and agricultural produce like grain or cotton stored either in the Banks' own godowns or they take possession of the customers' godowns as soon as the advance is made. Almost all the Indian Joint-stock banks conduct commercial

¹ The Central Bank of India has done valuable work in attracting small savings and developing Savings Bank departments in conjunction with home safes. Other Banks would do well to devote considerable attention to this aspect of their business.

banking and most of their advances are for a short-term period on liquid and easily realisable securities. Discounting of inland bills is not so prominent and nothing of the nature of acceptance business is undertaken by them. Of late a few of the bigger Indian Joint-Stock Banks are attempting to conduct foreign exchange business also but lacking such special facilities as rediscounting by foreign Central Banks and the possibility of securing cheap deposit money within this country they cannot hope to compete favourably with the immigrant exchange banks conducting business in our country. Agency, safe custody and internal remittance work form also an important part of their services to the customers. Unlike the American or the English Joint-Stock Banks they do not undertake 'trust' business on behalf of their customers.¹

In the Punjab an attempt was made to finance industries but it proved a failure. Even now some of these Indian Joint-Stock Banks lend on mortgage of properties but such lock-up advances form only a very small part of the total advances. Generally speaking they attract fixed deposits for which they agree to pay 4 to 5 per cent. for periods above six months and two per cent. on current accounts after stipulating for a minimum monthly balance say 200 or 300 Rupees. Though there is no authoritative statement explaining the nature of their business still it can be presumed that they minister to the needs of their clientèle and much depends on environment and the intentions of the founders and the managers of these banks.²

Some Statistical Information.

The blue-book dealing with banks classifies the Indian Joint-Stock Banks into two classes on the basis of the minimum paid-up capital and reserve of these Banks. All Banks possessing a paid-up capital and reserve of Rs. 5 lakhs and over are placed in class A and

¹ It is only recently that the Bank of India (Bombay) has determined to conduct this kind of business.

² A close perusal of the balance-sheet of these several banks will reveal to us that they have been conducting the following lines of business: (1) Keeping current accounts, (2) receiving fixed deposits, (3) Discounting inland bills of exchange, (4) Advancing money on securities and Government paper, (5) Acting as agents, (6) Issuing letters of credit, (7) Undertaking the purchase and sale of Government Stocks and Shares on behalf of their customers, (8) Realising dividends for their constituents, (9) Holding things for safe custody, (10) Remitting money and (11) Encouraging small savings.

in 1925 we had about 28 of such banks. Class B includes those banks which possess a paid-up capital and reserve between one lakh and 5 lakhs of Rupees. There were about 46 of such institutions and the following table taken from the Statistical Tables relating to Banks in India gives the reader an idea of the progressive growth of these banking institutions.¹ (See p. 2, 12th issue.)

CLASS A.

CLASS B.

Year.	No. of Banks.	Capital and Reserves (lakhs of Rs.).	Deposit (lakhs of Rs.).	Cash balances (lakhs of Rs.).	Year.	No. of Banks.	Capital and Reserves (lakhs of Rs.).	Deposit (lakhs of Rs.).	Cash balances (lakhs of Rs.).
1913	18	364	2259	400	1913	23	50	151	25
1914	17	393	1711	353	1914	25	55	126	29
1915	20	438	1787	399	1915	25	55	91	20
1916	20	461	2471	603	1916	28	63	101	17
1917	18	467	3117	765	1917	25	54	99	20
1918	19	602	4059	949	1918	28	63	155	37
1919	18	763	5899	1217	1919	29	75	228	54
1920	25	1092	7115	1631	1920	33	82	233	42
1921	27	1240	7690	1566	1921	38	100	323	44
1922	27	1064	6164	1204	1922	41	111	333	56
1923	26	923	4443	737	1923	43	111	326	61
1924	29	1071	5250	1130	1924	40	107	267	34
1925	28	1060	5449	1010	1925	46	118	342	68

¹ The steady growth of deposits taking place during the course of a decade should be noticed.

The proportion of cash held against the deposits must also be considered.

Great as is the value of the statistical information for discussions on banking it must be acknowledged that there is not yet a sufficient foundation to permit of a complete analysis of all the problems or to suggest a solution of them. The fundamental importance of banking demands an exact knowledge which can only be gained satisfactorily through a methodical analysis of bank accounts. To achieve this the Statistical Department should be empowered to call in more details of bank accounts for publication in the banking blue-book. A similar act drafted on the lines of the Jalpaiguri Gardens Act of 1912 is necessary to empower the officers to collect bank statistics.

The proportion of the cash reserve of the ordinary Joint-Stock Banks is roughly fifteen to nineteen per cent. When compared with other countries it is remarkably clear that our banks are maintaining a higher percentage of cash than other countries' banks which keep a cash reserve in addition to balances in the hands of the Central Bank of Issue against their deposits.¹

Percentage of Cash Reserves.

U. S. member Banks	...	...	...	9.5
The London Clearing Banks	...	...	...	11.5
Four French Credit Companies	...	...	...	11.5
Swiss Private Banks	...	...	...	8.0
Chartered Banks of Canada	...	...	...	11.0
(A group)—Indian Joint-Stock Banks	...	...	...	19.0

Savings deposits are being attracted on a large scale by the Indian Joint-Stock Banks. The Imperial Bank itself is attracting substantial amounts under this heading. Savings deposits in the Imperial Bank have grown at a more rapid rate than deposits in the P. O. Savings Bank itself.² But the increase of these deposits without a radical change in the loan and investment policy of the banks is dangerous. Unless some amount of protection by banking legislation is afforded to the holders of these savings deposits attracted by the commercial Banks the combination of commercial banking business with savings business opens the way to abuse and it is high time that much thought is given to this important aspect of our banking situation.

The Big Four of the Indian Money Market.

Head and shoulders above the rest of the Indian Joint-Stock banks stand, of course, the four banks which can appropriately be termed "the Big Four" of British India: The Allahabad Bank, the Punjab National Bank, the Central Bank of India and the Bank of India. Their present-day importance can be measured by the fact that their combined deposits in 1925 amounted to an important proportion of the total deposits attracted by the Indian Joint-Stock banks.

¹ See Burgess, "The Reserve Banks and the Money Market," p. 36; as for the item of Indian Banks, see Banking blue-book.

² See the Annual Reports of the Controller of Currency.

(Rs. 1,000 omitted.)

1925.			Paid up capital.	Reserve.	Deposits.	Cash balance.
The Allahabad Bank	...	...	3,550	5,027	94,516	14,798
The Bank of India	...	...	10,000	8,519	1,01,995	24,234
The Central Bank of India...	...	...	16,813	11,370	1,39,651	30,848
The Punjab National Bank	...	...	3,084	2,587	70,492	9,489
Total	...	...	3,3447	17,503	4,06,654	79,319

If these figures are compared with those of the 28 Banks belonging to the first category of the Joint-Stock Banks which possess more than Rs. 5 lakhs and over (Capital and Reserve) their strength can be easily detected.

		Paid-up capital.	Reserve.	Deposits.	Cash reserve.
28 Banks total	...	67,300	38,694	5,44,936	1,00,955

Thus they own roughly 50 per cent. of the total working capital of these 28 Banks and they have attracted nearly three-fourths of the total deposits and keep roughly four-fifths of the entire cash reserve kept by these 28 Indian Joint-Stock Banks.¹

It is indeed a pity that the Banking blue book does not give greater details with reference to the assets of the Joint-Stock Banks. Loans and discounts and investments are not mentioned so that the liquidity or non-liquidity of the assets cannot be easily grasped. Nothing can also be stated as regards the proportional commitments under the different operations. The investment percentages would be of value and in the absence of any details with reference to these any comparison with foreign banking institutions cannot be easily undertaken. As no detailed analysis of the loans is made it cannot be stated how the lending of credit is done. Unless the proportion of discounts, unsecured overdrafts, secured overdrafts, advances on goods, advances on book debits, and advances on securities to the total advances of the Banks are known it cannot be inferred whether they are wise or cautious in the granting of credit.

Bank Failures.

In spite of the fact that the existing Joint-Stock Banks have rendered good account of themselves there have been occasional

¹ See Statistical Tables relating to Banks in India (12th Issue).

failures. They are inevitable in an unco-ordinated and decentralised banking system where banks, which have committed the mistake of locking funds in "slow assets" fail to secure any help. The selfish policy of each for itself heightens the gravity of the situation. Such failures are constantly happening even in the organised banking system of the United States of America where the state takes direct control and interest in the banking institutions of the country. There is a great co-ordination and co-operation existing among the different banks and their clearing houses are active institutions interested in the prosperity and growth of their banks. But bank failures are of daily occurrence¹ and Dr. Sprague says, "I feel that the problems of these inferior banks are of the utmost importance for the satisfactory functioning of our banking system. The number of bank failures in those sections of the country has been enormously large. All of the bank failures that were failures of member banks were of institutions that were heavily indebted to the Federal Reserve Banks. These seem to me to be matters of the utmost importance in the conduct of the Federal Reserve System."² While bank failures may be incidental occurrences a long series of bank catastrophes is generally styled a crisis. A bank crisis may inaugurate days of panic when there would be general destruction of credit and the most complete interruption of its banking facilities."

Banking Crisis of 1913-1916. .

Most of the 'Swadeshi' banks were viewed with jealousy and disfavour and the older banks refused to lend a helping hand in times of trouble. As Lala Mulkraj says, "the political history of India got repeated in the attitude of these banks towards each other." The Official Committee of Lahore which was appointed to enquire into the causes of bank failures in the Punjab, writes that "during the crisis there was no co-operation between them and the English Banks or between them and the old-fashioned Indian Banks." Lala Harikishen Lal says that "the old banks brought the new ones to trouble and did their best to eliminate the new

¹ No less than 956 Banks failed in 1926, an year of unparalleled prosperity and an equal number failed in 1927. See Peel, Economic Impact of America, p. 305.

² Quoted from the Evidence before the Stabilisation Committee by Peel, *ibid*, p. 308.

comer."¹ Lala Mulkraj says, "there were formidable forces arrayed against Indian Banking in 1912. A destructive genius in the person of Rai Bahadur Moolraj arose to destroy all banks, good, bad or indifferent. He exploited all the forces that could be commanded for destruction. Tongue and pen were both used freely and a religious paper was got under control and converted into a weapon for the financial ruin of the country. This fright created mistrust and a run upon Indian Banks commenced." The Presidency Bank of Bengal refused to lend even on Government security in spite of the favourable recommendation of its Lahore Branch.

Whatever might be the reason, there was a widespread failure of these banks during the years 1913-15. Of all the banking crises which India experienced that of 1913 to 1915 was the most disastrous one. During the years 1829-1832, in 1857 and in 1863 to 1866 there were indeed several bank failures and much capital was lost during these times. In the crisis of 1913 to 1916 "no less than 31 per cent. of the total paid-up capital of the Indian Joint-Stock Banks has been lost." Many of the depositors were ruined. The Indian people have again to be educated in banking business and the banking habit has to be created afresh. This widespread failure gave scope for the statement "that Indians are incapable of managing Joint-Stock Banks." Pandit Madan Mohan Malavya gave a crushing reply to this malicious charge.² Such failures have occurred in all countries and they are indispensable concomitants to the early era of Joint-Stock banking.³ Indian banks have failed even though they were managed by European managers. According to Lala Harikishen Lal "three or four dozen banks managed by Europeans failed in this country during the last hundred years."

¹ *Vide* Lala Harikishen Lal's presidential address at the Indian Industrial Conference.

² See G. F. Shirras, 'Memorandum on Banking,' p. 6.

³ *Vide* the Minority Report of the Indian Industrial Commission.

⁴ During the early days of banking in England many of the country banks failed. There were 425 bankruptcies in 1725 ; 466 in 1727 and 338 in 1728. Several country banks failed during 1814 and 1816. As many as 18 banks failed during a single month in 1825. Till 1844 the business of weeding out incompetent banks continued. In the United States of America about 517 National Banks failed during the year 1865 to 1911. About 48 National Banks failed during 1921 to 1923.—Report of the Controller of Currency.



A close study of the causes for their failures will reveal the fact that mismanagement due to inexperience in banking affairs accounts for most of the failures. The Official Committee of Lahore says all "the evidence produced before us insisted on the want of business knowledge and inexperience in company promoters, managers and staff as a *primary* cause of failure. There were few competent managers whether of banks or of industrial concerns. Consequently egregious blunders were committed and some of the so-called dishonesty seems to us very like ignorance, much of it was due to anxiety to cloak losses." The inexperienced directors were unable to do their work properly. The ignorant share-holders could not satisfactorily exercise their rights and duties.

Most of the directors that were elected to supervise the manager's work and help him with their advice were wrongly chosen and they were easily led away by the opinion of the manager. There was a story current in the Bombay trading circles that the director of one bank did not know English and when the proceedings of the Board were being conducted in English he simply voted blindly on the important questions he had to decide. Such kind of 'dummy directors' could never influentially dictate the banking policy. Of course we had no "guinea-pig" directors but still the first batch of directors of the Indian Joint-Stock Banks knew little of this banking business conducted on the joint-stock principle.¹ These directors were no doubt successful merchants or were men distinguished in one walk of life or other but the mere fact that they have managed one kind of business successfully is no guarantee of their ability to work as directors of a Joint-Stock bank.

The managers of the banks were incapable men and had very little knowledge of banking theory. No doubt they were men of some experience but an efficient manager of a Joint-Stock bank should possess these sterling qualifications to make his bank a successful

¹ The first acknowledged duty of the bank directors is to see that the funds of the bank are safely employed. They should be men possessing reliable knowledge of accounts, business and general working policy of the bank. They should not interfere too much with the administrative routine of the office. They must realise that the Secretary's opinion is entitled to great weight but at the same time they should not be carried away by his wishes. They should have the moral courage to refuse better terms to a director than an ordinary borrower

one.¹ It has been stated that these managers were dishonest and selfish but Balak Ram Pandya, auditor of accounts, Lahore, refutes the charge emphatically.² Lala Mulkraj, the manager of the Doaba Bank, testifies to the integrity of the staff in the following language, "as for their integrity I may mention that during the ten years' life of the Punjab Co-operative Bank out of a staff of eleven officers only one man was guilty of defalcation of a few hundred rupees."³

The Indian share-holders of the Joint-Stock banks never performed their duties properly.⁴ The share-holders should realise that they are co-partners with many others. Their duty is "to put the saddle on the right horse" and see that the officers of the bank are doing responsible duties in right earnest. In no case should they entrust too much power to their manager. They should not place too implicit a confidence in their salaried staff to acquiesce in their doings. Again many of them were not in a position to scrutinise the balance-sheets of their bank and climb over the 'balance-sheet dodge' as it is styled. They

¹ According to George Rae "the bank manager should possess the following qualifications. There should be total absence of bias, religious, political or social, in his mind. He should be quick enough to perceive any change in the circumstances of the customers. There should be no hesitating, dubious and capricious manner. He should be never indolent. Whenever he is in doubt as to the safety of a transaction he should give the bank the benefit of doubt. He should never fly into a passion or bandy words with customers. He should see that all customers are treated respectfully by his officers. In short he should not tolerate any insolence of office at his bank." Many of our bank managers did not possess these essential qualifications.

² In his evidence before the Indian Industrial Commission he says, "when we compare the recent bank and industrial failures in the Punjab with similar incidents in other countries we are astonished at the comparatively small proportion of cases in which the failures in our case were due to dishonesty or selfishness. The price we have paid for our inexperience is undoubtedly heavy but it is by no means heavier than what other countries paid before us. If we have learnt the lesson which the disasters of the last few years so impressively teach there is surely no room for despondency."

³ See his evidence before the I. I. Commission, the Punjab Volume, p. 290.

⁴ George Rae enumerates the following duties of the share-holders; "he should make no line of hostile remark against the bank in times of run. Whenever he hears a bad rumour he should in the first instance convey it to the manager. He should not give currency to any calumny against his bank. He should be the guardian and police of banking credit. His duty is to stand by his bank in times of panic. He should not sell the bank shares at the time of a panic for he would become a bell-wether followed by a score of sheep like himself. His primary duty is to increase the business of his bank and bring more customers to it." *Vide* "Country Banker."

did not choose their men well. The secret of banking success lies in choosing the best men and trusting them completely.

Some other causes undoubtedly hastened and accelerated the downfall of these banks. The difference between "the paid-up capital, subscribed capital, and authorised capital" was acting as a handicap from the beginning. As the law did not check this malpractice, they took advantage of this fact to trade on the ignorance of the public who were unaware of the difference between the three kinds of capital. To curb this malpractice a heavy stamp duty has been recommended by J. M. Keynes,¹ but this would undoubtedly penalise the sound concerns which wish to conduct joint-stock banking.

In addition to this every bank should be forced to have a certain amount of minimum paid-up capital, say 50 per cent., before it commences its business.² While the paid-up capital was small, the incidence of cost was very high.³ Liberal salaries, travelling and halting allowances and high commissions to agents and canvassers were paid.

Some of the banks contracted the pernicious practice of lending money on their own shares. The failure of the first Benares Bank and that of the Credit Bank of Bombay are attributed to this practice. It is a matter of great satisfaction to see that the Imperial Bank is not allowed to lend money on its own shares, though they may be taken up as an additional security for covering loans. The Charters of the Swiss National Bank of Czechoslovakia, the Reserve Bank of South Africa, the Bank of Spain and the Imperial Bank of Spain⁴ forbid them from making any loans on the security of their own shares or purchasing the same.

¹ Such a rule exists in the Canadian Banking System. The minimum required capital is \$500,000 of which all must be subscribed and one-half paid before the bank commences its business.

² See Keynes, "Indian Currency and Finance," p. 232. "The stamp duty should be proportional to nominal capital. He instances the case of a comic opera bank registered in Calcutta in 1910 with about Rs. 2,00,00,000 without having any paid-up capital of its own at the time of the last return."

³ "In the case of many of the Punjab Banks the capital was seldom higher than 4 or 5 lakhs. The People's Bank had nearly 80 branches. The result was that the money cost them at least 12 per cent., 6 per cent. they paid to depositors and their expenses amounted to 6 per cent. on the capital." See the evidence of Lala Damodar Das, Vol. 5, The Indian Industrial Commission, p. 254.

⁴ See Kisch, "The Central Banks." See Appendix I, Summary of the Charters of these Banks.

In some cases there was no strict auditing of the accounts. It was a mere farce and the auditor, who was either a creature of the manager or a principal of the fraud, was lax in his duties and connived at the bad practices of the managers.¹ The auditor should be a man of much experience in the science of book-keeping and the analysis of accounts. His main duty is to place the facts as they appear to his light. He should be "the detective of the shareholders who should keep a vigilant eye on the directors always." They can exercise real control over bank policy by frankly discussing the different accounts with the management of the Bank and refuse to give a clear certificate if the management is not carefully done. The auditors should see that the directors are not nursing huge and growing accounts year after year long after they have become doubtful. This is the grim skeleton in the banking cupboard and the auditor should expose it to the shareholders.

Some of the banks indulged in speculative commitments.² The Indian Specie Bank's purchase of silver and its attempt to corner silver³ became a miserable failure and soon led to the closing of its doors. This was one of the factors which brought about its downfall. It had roughly silver worth £3,000,000 on its books when it closed its doors on 1st December, 1913.

Many of the banks were performing quite the opposite of commercial banking business. Instead of making all their assets easily realisable or keeping them in a liquid shape, they locked up their funds so that they were no longer "quick assets." What the commercial bank should aim at is 'immediate convertibility.' All the short-dated deposits can be demanded at any time and it is unwise to invest them in long-dated loans to industrial companies.⁴ The Bank

¹ See the evidence of Lala Damodar Das : "The Bank of Peshawar and the Hindustan Bank gave out false balance-sheets and this is rendered possible because the auditors who audited the accounts were not real auditors in the true sense of the word. They were merely accountants."—*Vide* p. 258.

² "The excessive loans made to the cotton ginning factories were properly speaking speculations." The Hindustan Bank of Lahore granted loans to the Panjab Musical Association, Ltd. (a theatre with no capital) and to the Panjab Bros. and Co. (a speculative shop in Karachi). *Vide* Indian Industrial Commission Report, Vol. 5, p. 254.

³ For a description of this corner and reasons for its failure see Benjamin White, "Silver : Its History and Romance," pp. 235 to 237.

⁴ Both the Punjab National Bank and the Co-operative Bank lent about 10 lakhs to a

managers failed to realise the vast difference between "immediate" and "ultimate" convertibility. The substitution of the latter for the former means the question of life or death to the bank. They sacrificed the principle of liquidity which should be borne in mind by every banker. Instead of constantly controlling the liquidity of the resources at short intervals by frequent general inventories with the greatest care, and instead of keeping a proper composition of security and holdings in their portfolio against their total obligations, they locked up their money in "slow assets." According to Reisser "the security and maintaining of the liquidity of the assets is a most essential task incumbent on the banker. Indeed in view of the variety of claims made on the resources of bankers and banks and of the multitude of aims formed by them it is one of the most difficult problems of banking policy. It is all the more difficult since the establishment of the right proposition of the so-called quick assets to the liabilities, specially obligations falling due at any time or within a certain period does not always depend solely on the will and discernment of the bank. Possibilities have to be reckoned with for instance, that the issue of new shares required to restore the necessary liquidity of the bank's resources after a great increase of business is impossible during bad or critical times; that consequently its assets would be tied up just at the very moment when it might be called upon to realise general embarrassment by proper intervention."¹ Several of the 'Swadeshi' Banks were not in a hopelessly rotten state and this can be proved by two facts. The survival of the Punjab National Bank shows what a capable Indian directorate and staff can do under trying circumstances. Some of the liquidated banks paid the depositors in full.² Most of these Indian joint-stock Banks paid a very high rate of interest to the depositors. The Bank of Burma undertakes to pay 6 per cent. on

single gentleman who started a network of ginning cotton factories and presses and put up flour mills. 90 lakhs of Rupees out of a crore or so in the People's Bank have been sunk in machinery and buildings and the liquidators would not get even half of that money in less than ten years. *Vide* the evidence of Lala Nanda Lal Puri as also the evidence of Lala Damodar Das, Vols. No. 5. The I. I. Commission Report.

¹ See Dr. R. Reisser, "The Great German Banks—American National Monetary Commission Report."

² The Marwar Bank and the Punjab Co-operative Bank. The liquidators of the People's Bank were able to give more than 100 per cent. dividend to its creditors but the shareholders were not paid anything.

deposits. In order to earn this, business out of the banking line had to be conducted and this precipitated its downfall. In the Punjab there was a regular competition to secure deposits. In order to induce several widows and orphans to deposit their money, banks agreed to pay eight per cent. under various pretexts.¹ They had to lend at a very high rate of interest and lending at a high rate they could not have good security. Ruinous rivalry produced by competing deposit rates forced the banks to entertain illegitimate business.

In some cases, notably two or three, banking business included "medical attendance and coach building." The Hon'ble (now Sir) T. Smith of the Allahabad Bank² says, "an institution has no right to be called a bank which undertakes coach-building, ekka repairs and medical attendance, the manufacture of soap and oil and certain things as machinery or engages in trade or manufactures of any sort even though it be stated as follows:—the leasing, hiring and purchasing of all commodities and substance which can form the subject of purchase and sale." The banker's profession is to take care of the community's floating cash and to turn it to good account, that is, to make it productive, particularly by placing it at the disposal of others engaged in production.

The Presidency Bank did not realise their function of being residuary trustees, and bankers' banks. Perhaps as Keynes suggests "they were not strong enough to support the whole burden." Their apathy towards the struggling Indian Joint-Stock Banks has been vigorously criticised by the Lahore Committee in its evidence before the Indian Industrial Commission.³

¹ If the deposits belonged to minors, widows, orphans or charitable institutions they would give eight per cent. While the Bank of Bengal rate was on the average about four per cent., the Punjab banks did not care to regulate their rate for deposits in conformity with the standard rate. On the Bombay side however the deposit rates were governed by the Bank of Bombay rate.

² See his Evidence before the Indian Industrial Commission (The United Provinces)—Volume I and evidence before the Chamberlain Commission.

³ Mr. W. S. Thatcher complains that this is no valid explanation for bank failures. See his review of Wadia and Joshi, "Money Market in India," *Economic Journal*, London. But he has failed to understand the character of the 1913 banking crisis. It was a prosperity crisis and as in the 1907 banking crisis of the U. S. A., if proper help had been rendered, there might have been no failure on the part of the solvent banks at least. It is on account of this reason that Indians feel so keenly the lack of sympathy on the part of the European Banks of that time.



Some of the Indian Joint-Stock Banks were got up to satisfy some transitory caprice and did not arise to satisfy the legitimate banking and trading requirements of the people. In the city of Bombay some banks arose in this way, because the powerful magnates who were not included in the directorate of a bank got up another one under their patronage, and were thus the creation of interested parties. It has been suggested that "the jealousy of Exchange Banks is responsible for the failure of the Indian Specie Bank." This bank under the able guidance of the late Chunilal Saraiya opened a branch in London with a view to facilitate its business in pearls and silver. The Exchange Banks resented competition in the exchange business and the rate-cutting that ensued is held responsible for its failure. But as a matter of fact its speculative purchases of silver and the refusal of the Government of India to buy the whole of its silver at its hands precipitated its downfall. The bank also lost heavily in loans advanced to jewellers and the *badla* business of Fazul and David shares.

In some of the Indian Joint-Stock Banks the bank officials took too much of the loanable credit and invested it in their own enterprises.¹ The failures of the Lahore Bank, the Doaba Bank, the Hindustan Bank (Lahore) and the Industrial Bank were due to this fault. The Bank of Burma failed in 1911 and out of a total working capital of 1 crore 19 lakhs it advanced $\frac{1}{3}$ of it to a firm in which the directors were interested. The sinking of too great a proportion of the bank's funds in one industry is a grave evil and this was not heeded by the European manager of the above bank. No bank ought to commit the fatal mistake of "placing all its eggs in one basket." It must never get itself entangled in one or two or three huge and over-mastering accounts for the smashing up of such a big customer would spell disaster to the bank. During the course of every-day run of its bills, advances, overdrafts and investments some bad debts may be created here and there but these will not be a matter of

¹ "Of the total advances of Rs. 1,07,09,000-14-1 we find that no less a sum than Rs. 71,72,637-13-1 have been advanced to companies or other concerns in which certain directors of the Bank have been interested either as individuals, directors or as joint-borrowers. See the liquidator's report relating to the People's Bank, Appendix VIII, Memorandum on Banking.

serious concern. A bank must be careful in "distributing" its risks as Reisser puts it.

Excessive inter-connection and the interdependence of banking and industrial concerns under a board of common directors as in the case of the Punjab companies is fraught with harmful results. The Rungpore Bank was started by the Directors of the Rungpore Tobacco Company in order to secure cheap loans and the Rungpore Bank gave loans to this Company which was not earning any profits at all.¹ Thus the bank directors stood as both creditor and debtor in the same person. This is only one illustration of the unbusinesslike way in which loans were granted. It is always an unsound financial principle that lenders and borrowers are to be the same persons.

Some of the Indian Joint-Stock Banks started with enormous nominal capital and they combined high-sounding titles with it so as to mislead people as to the actual strength of their institutions. A recent instance of a bank making "a colourable imitation of the name of another bank" came up for judicial enquiry. Mr. Justice Mulla refused to permit the defendant bank, the National Bank of Indore² to carry on business under that name.

Most of the Indian Joint-Stock Banks did not maintain adequate cash resources against their demand liabilities. The percentage of cash to the liabilities was only eleven per cent. and in some cases it was lower than this. The Exchange Banks and the Presidency Banks kept a much higher percentage of cash against liabilities than this eleven per cent. Frankly speaking these Indian Joint-Stock Banks have not understood the problem of banking business. As one eminent banker says, "if the banks were to keep in cash all the money deposited with them business would come to a standstill and a crisis would ensue. If on the other hand banks were to lend all the money on deposit with them, a general failure and collapse would follow after a period of over-stimulation. Between these extremes lies the middle course, the finding of which is the problem of banking."

In some cases dividends were paid out of the deposits that were coming into the bank for the capital of the bank had disappeared

¹ See Evidence before the Indian Industrial Commission, the volume relating to Bengal.

² This bank went into liquidation on 1st April, 1925.

long before this time. The balance sheets of some of these Indian Joint-Stock Banks were very good instances of window dressing. Some banks manufactured blooming balance-sheets showing a large amount of assets whereas these banks were really working at a heavy loss. The practice of paying dividends when they were not earned was not given up.¹

Such and similar instances of mismanagement and lack of proper organisation of the banking business can be quoted but the "two primary causes that led to the collapse of the banks are (1) the inexperience and the defects of the machinery inevitable to the starting of a new venture, (2) the lack of palliatives or remediable action such as Government itself or quasi-government agencies, *i.e.*, a State-supported provincial bank might supply."²

Again the practice of mutual drawing of accommodation bills between the various banks which we meet with in the foreign money markets would have been of some help to the sound and solvent banks in the hour of their trial.

Recent Bank Failures.

Though there was a brief respite during the years 1918 to 1920 when the mortality rate of banking companies fell to a low figure still from 1922 there has been an increase in the number of bank failures. The following table indicates the number of failures and the amount of paid-up capital lost on account of these failures. (See p. 24, Statistical Tables relating to Banks, 12th issue.)

Year.	No. of Bank failures.	Total Paid-up Capital of these Banks,	
		Rs.	
1916	13	4,22,901	
1917	9	25,25,914	
1918	7	1,46,185	
1919	4	4,02,737	
1920	3	7,24,217	
1921	7	1,25,329	
1922	15	3,29,991	
1923	20	4,65,47,325	
1924	18	11,33,623	

¹ See the Evidence of Rai Bahadur Lalla Damodar Das before the I. I. Commission, Vol. 5, p. 225.

² *Vide* the Evidence of the Official Committee of Lahore before the Indian Industrial Commission.

The most important of the recent bank failures is the failure of the Alliance Bank of Simla in April 1923. It was first started in or about 1875. It was an "English-managed" enterprise from the beginning and most of the depositors were Government civil and military officials. Due to their support the bank had a very successful career from the very beginning and in order to cope with its increasing business more capital was called in and more reserve accumulated out of the profits. The number of branches began to increase steadily. The amalgamation of the bank with other banks, as the Punjab Banking Co., the Delhi and London Bank and the Bank of Rangoon, contributed much towards further increase of its capital and about 37 branches were established by 1920. It conducted foreign exchange business successfully and was regarded as one of the premier Indian exchange banks.¹ To economise its expenditure and have a direct hand in the management of its London business, the business of Messrs. Boulton Brothers and Company was absorbed. About 1922, the late Sir David Yule had to visit India and reorganise the business on a sound footing but nothing could be done to avert the impending crash brought about chiefly by locking up money in subsidiary companies started by Boulton Brothers. The unregulated state of banking gave free scope to the bankers to pursue the wrong path and the Alliance Bank of Simla had to close its doors in April, 1923.

It is apparent that the lives of the dead (banks) have not been studied in detail and the lessons of their failures have not been learnt and unless right inferences are properly drawn from the historical survey of the banking crisis this tale of banking woes would be repeated and Indian banking would have to pass through such disastrous periods till the law of the survival of the fittest would operate remorselessly and the few but perfect banking institutions alone would remain in the field. The utility of banking legislation at this stage of banking progress opens up a wide subject which will have to be dealt with in a detailed manner in a succeeding chapter.

¹ The current account and savings bank balances with the bank amounted to 15½ crores on 30th June, 1922, and by April, 1923, they had fallen to 8½ crores of rupees and the shares of the bank were quoted at a premium on the Calcutta Stock Exchange.

Suggestions.

The bigger Indian Joint-Stock Banks should play a more useful part in the financing of the internal trade of India. The charges for inland remittance should be reduced to as low a figure as possible. Instead of financing speculative investors who dabble on the stock exchange, they ought to extend their business into the interior of the country and this would not only lead to the 'popularising' of banking business but they would tend to standardise the inland instruments of exchange, and inculcate better business methods and banking habit in the minds of their customers. A greater use of bills of exchange has to be insisted upon. Much can be done in this direction by the reduction of the stamp duty and the Government consenting to act as drawees in case of all supplies secured by it from local manufacturers. Such bills can be easily discounted by any of the Joint-Stock Banks and the Central Bank of the country might use them for currency purposes. It is the duty of these banks to develop trade acceptances in lieu of open accounts and if merchants give preferential terms to purchasers willing to accept such bills instead of opening credits, banks in their turn ought to give preferential rates to these merchants in the matter of discounting these bills as compared with those of merchants who wish to borrow on overdrafts. The Central Bank would have to give preferential discount and re-discount rates on trade acceptances. This is how trade acceptances are being popularised in the Dominion of South Africa as a result of the recommendations of the Kemmeror-Vissering Committee. They must make special efforts to entice the small depositor.

The smaller Indian Joint-Stock Banks which are merely loan agencies must tend to educate the local businessmen to have a banking account, aspire to collect the maximum amount of surplus balances from the community, and act as the intermediary between the Central Bank and the local businessmen. They can educate the local people by undertaking to buy and sell the Government and Stock-exchange securities and thus create the investment habit in the minds of the locally rich people. The sale of Gold and Silver bullion would increase the scope to secure greater profits. A certain amount of push is needed to strike out new avenues for the profitable utilisation of their capital, always bearing in mind that it is others' money

that is being lent. It is in this direction that their salvation lies and the reduction of capital on the part of the smaller Indian Joint-Stock Banks as has been done in a few instances is a tacit admission of inability on their part to conduct sound banking business. The Erode Bank of Erode, the Coimbatore Union Bank of Coimbatore, the Bangalore Mercantile Bank of Bangalore and the Mercantile Bank and Commercial Bank of Vellore have reduced their capital during the years 1924 and 1925.¹ This is not the real solution. There should be courage in developing this class of business outlined above which will not be remunerative at first. The interests of the shareholders would be very important but these must be prepared to undertake certain sacrifice and face loss for some time to come but eventually it would pay them amply. They should not concentrate their attention solely on the declaration of mere dividends but place greater sums into the reserve fund and provident or pension funds and special depreciation funds or branch banking reserve fund. These banks must become national institutions endowed with the trust of the community. This they can never hope to secure unless they extend the range of the facilities offered.

¹ See Statistical Tables relating to Banks in India, 12th issue, pp. 14, 15, 16.

CHAPTER VIII.

THE LOAN COMPANIES OF BENGAL.

The Loan Companies of Bengal—The small Banks of South India—*Working Capital*—Unfettered Competition—Rationalise the banking industry—Specimen of a loan company or small bank's operations in Bengal—The defects of these loan companies and small banks—Proposed lines of action—The example of the United Kingdom—The concentration movement in German banking—Its results—Impossibility of amalgamation with bigger banks—The main advantages of the amalgamation movement—Other expected advantages—Can the proposed Federal Bank stem the tide?—Why not depositors as directors?—The Bengal Bankers' Federation—The aims of the Federation—General long-period effects—Difficulties in the path of the amalgamation movement—Conclusion.

The Loan Companies of Bengal.

The blue book on the Joint-Stock Companies records the existence of 191 banks and 187 loan companies in Bengal.¹ When I got into touch with some of the directors of the loan companies they suggested the existence of many more and it is quite possible that several loan companies might have been started during 1926, 1927 and 1928. Roughly there are about 500 to 600 loan companies operating in the province of Bengal.

Even prior to the starting of the Oudh Commercial Banking Co. (1881), there were indeed a very large number of small banks and loan companies with a small amount of paid-up capital. The following table shows some of the earliest loan companies still conducting business at the present day without interruption.

Name.	Date and year.	Authorised capital.	Subscribed capital.	Paid-up capital.
		Rs.	Rs.	Rs.
Batalal Loan Office ...	17-11-73	20,000	18,000	18,000
Bogra " ...	5-11-74	60,000	59,030	59,030
Dacca " ...	29-3-80	1,00,000	62,200	62,200
Faridpur " ...	4-3-71	20,000	19,820	19,820
Jessore Loan Co. ...	12-4-76	1,20,000	1,00,000	1,00,000
Munshiganj Loan Office ...	29-7-76	20,000	12,060	12,060
Mymensingh Loan Office ...	2-9-73	1,00,000	80,400	80,400
Nasirabad " ...	24-9-75	50,000	45,000	45,000
Sabar-Sherpur Loan Office ...	26-6-76	20,000	16 210	16 210
Tipperah Loan Office ...	25-3-71	1,00,000	1,00,000	1,00,000

¹ See the Annual Report of the Registrar of the Joint-Stock Companies, 1925-26.

Small Banks of South India.

It was not only in Bengal that such concerns existed but in the Native States of Mysore and Travancore several small banking concerns were started in 1875 and the Bangalore Bank, though under non-Indian management was started in 1868 and is still conducting sound business under able management. Even now several of these small banks exist in South India and these should on no account be confused with the Nidhis and Kutte-Chitti institutions.

Working Capital.

A glance at the above table quoted from the blue book shows how ridiculously poor is the paid-up capital of these loan companies. The tendency of the smaller banks of South India is the same. This does not mean that their *working* capital is also small. Some of them have succeeded in attracting huge deposits but as the Statistical Department does not publish the figures about deposits, advances and other banking operations it is not possible to have an idea of their working capital or the magnitude of their operations.

Unfettered Competition.

Another peculiar feature is the presence of a large number of these loan companies, as many as five to seven of these isolated small loan companies, which are working in a restricted locality on mutually antagonistic lines. Bogra, Comilla, Faridpur, Gai-bandha, Jalpaiguri, Jamalpur, Jessore, Khulna, Kurigram, Madaripur, Mymensingh, Rajshahi and Rungpur have a number of these loan companies working over a delimited local area. The same is the case with the small banks of South India. Bangalore, Calicut, Chamrajnagar (Mysore), Palghat, Raichur, South Kanara, Telli-cherry, and Tinnevely have a large number of these small banks in addition to Nidhis and Chit funds. It is indeed strange to find that the premier Native State—Hyderabad—has very few, only three indigenous banks of its own. The district of Mymensingh in Bengal has, on the other hand, the largest number of these loan companies and about 61 of them exist in this populous and wealthy district.

Rationalise the Banking Industry.

While the rationalisation of every kind of industry is progressing at a rapid rate in every economically progressive country there has been unfortunately no such desirable move in banking business. Although a few instances of spontaneous banking amalgamations occurred in the past with desirable consequences in each case of amalgamation, the movement unfortunately has not spread to the loan companies of Bengal. The necessary unification of the individual loan companies and small banks has not taken place so as to create a comparatively small number of powerful business units possessing the three canons of soundness, adequacy and efficiency which any sound banking company should possess.

As a consolidated balance-sheet of the loan companies cannot be presented, nothing beyond a rough idea can be gained by studying the typical balance-sheet and annual report of a loan company. The following is the *Fourteenth Annual Report* of the Ranaghat People's Bank, Limited (registered under Act II of 1912):

“ The personnel of the Board of Directors during the year under review was entirely different from that of the previous year. There were 11 members on the Board. Altogether 21 meetings of the Board were held during the year.

Capital.

The capital issued to the shareholders was one lakh of rupees divided into five thousand shares. The amount of the working capital during the year was as follows:—

				Rs.	A.	P.
(a)	Share	...	...	35,424	0	0
(b)	Deposits of members	...	...	26,291	0	3
(c)	„ „ non-members	...	...	51,445	12	3
(d)	Reserve fund	...	...	9,100	0	0
(e)	Building fund	...	...	1,719	10	0
(f)	Building depreciation fund	...	...	200	0	0
(g)	Bad debt fund	...	...	2,400	0	0
				126,630	6	6

There were 804 members towards the latter part of the year, 1926-27.

Shares.

During the year realisation due to shares amounted to Rs. 1,865 and Rs. 2,610 have been returned. At the end of the year 3,568 shares were sold to shareholders for which Rs. 35,474 have been realised. Out of Rs. 206 which has to be collected about Rs. 80 have been realised leaving Rs. 126 still uncollected. Fourteen shares have been cancelled on account of the yet unpaid money.

Deposits.

During the year under our consideration Rs. 2,615 have been deposited by the members and Rs. 2,104-5-0 by non-members. The amounts that have been returned by the members and non-members are respectively Rs. 11,850-7-0 and Rs. 5,129. By 31st March, 1927, Rs. 26,291-0-3 were entrusted to the Bank by the members and Rs. 51,445-12-3 have been paid to the depositors as interest and interest to the amount of Rs. 2,309-2-3 have still to be paid. The rate of interest is 7 p. c. During the year Rs. 12-10-6 have been obtained under the head 'discount' and Rs. 30 are still to be realised.

Loans and interest on them.

During the year Rs. 49,452 have been advanced to members as loans and principal to the amount of Rs. 51,287-14 has been realised. The interest recovered on loans during the year amounts to Rs. 7,128-0-3 and Rs. 5,762-3-0 remain to be collected under this head. The pleaders work without fees.

Bank Building.

The Bank building has cost Rs. 5,576-12 in all and it is being used the last three years. Building Fund for extension now amounts to for Rs. 1,719-10 and the Building Depreciation Fund amounts to Rs. 200.

Assistants.

There are two salaried assistants. There is also a peon on Rs. 15 per month. The total expenses (salary, provident fund, audit fee,



stationery, postage stamp, printing, purchase of forms) have been Rs. 1,206-15-3. The provident fund for the assistants amounts to Rs. 233-8-6.

Consolidated Reserve Fund.

Out of the Reserve Fund Rs. 6,267-8-0 have been invested in the Postal Cash Certificate.

Profits and Reserve Fund.

The net profit during the year has been Rs. 2,345-9-3 and last year's excess profit was Rs. 36-10-2. Out of a total of Rs. 2,382-3-5, after deducting according to the bye-laws of the bank one-fourth of Rs. 452-13-4½, entrance fee, etc., the sum of Rs. 990 paid to the Reserve Fund. The Reserve Fund of the Bank comes up to Rs. 10,090.

Dividend.

After deducting the sum that has been kept apart for the Reserve Fund the remainder Rs. 1,392-3-5 may be divided as follows:—Payment of dividend at the rate of Rs. 3-2-0 per Rs. 100 would come to Rs. 835. Bad Debt Fund would come up to Rs. 305. Rs. 200 might be kept in the Building Fund and Rs. 7-3-5 would be made over to the next year.

Miscellaneous.

The issued capital of the Bank is one lakh of rupees, half of which has been kept as reserve liability. Out of the remainder Rs. 50,000, the capital has come down to Rs. 35,474 during the last 14 years. This is due to the fact that the members of the Bank not being able to pay off the whole of the borrowed money in cash, repay their loans from the amount of the shares that stand to their credit.

The proposal that a director can be a debtor was accepted by the last general meeting and the Bank had to experience much difficulty in meeting a run made on it by the depositors who withdrew Rs. 15,973. This run on the Bank was stopped by the Registrar not accepting this proposal. The outgoing directors take the credit of realising decrees

to the sum of Rs. 6,475-10-0 out of what was considered last year by the auditor as bad debts.

The volume of suits is increasing steadily. This fact is responsible for the falling off of the rate of dividend. The Bank accepts deposits at the rate of 7 per cent. and lends at the rate of 9 per cent. The auditor suggests the introduction of the rule of short-term and long-term loans or increase of the rate of interest for all borrowers."

The following balance-sheet gives the readers some insight into the bank's operations:—

<i>Liabilities.</i>			<i>Assets.</i>		
	<i>Rs.</i>	<i>A. P.</i>		<i>Rs.</i>	<i>A. P.</i>
1. Due to shares ...	35,474	0 0	1. Cash in hand ...	4,963	6 11
2. Deposits by members ...	26,291	0 0	2. Cash Certificate ...	7,534	6 0
3. ,, non-mem- bers. ...	51,445	12 3	3. Land and building ...	6,126	15 6
4. Unpaid interest ...	2,309	2 3	4. Principal due ...	1,10,684	14 0
5. Unpaid dividend ...	2,474	11 0	5. Interest due ...	5,762	3 0
6. Due to office expenses ...	103	8 0	6. Discount ...	30	0 0
7. Excess collection to be returned. ...	14	6 0	7. Present price of furniture	337	8 0
8. Provident Fund .	233	8 6	8. Postage stamp in hand...	4	10 6
9. Suspense deposit ...	2,887	14 0	9. Due from Pleaders ...	244	9 6
10. Reserve Fund ...	9,100	0 0	10. Costs of suits due ...	1,378	9 0
11. Building Fund ...	1,719	10 0	11. Interest due from Post Office.	79	1 3
12. Bad Debt Fund ...	2,400	0 0			
13. Building depreciation Fund.	200	0 0			
14. Excess undivided profit	36	10 2			
			TOTAL ...	1,37,146	3 8
TOTAL	1,34,800	10 5			
Profit ...	2,345	9 3			
GRAND TOTAL ...	1,37,146	3 8			

The Defects of the Loan Companies or Small Banks.

Some of the acknowledged defects of the loan companies are the lack of proper book-keeping methods, a staff of trained bank officers and whole-time bank directors who devote their energy solely to the

I am obliged to my student for an English translation of the proceedings of this Loan Company.

banking profession. Very often the managing directors pack the Board of Directors with friends of their own choice and real election of directors by the shareholders is not generally the rule. They do not encourage the free use of credit instruments like cheques and bills of exchange. Short-term deposits are not cared for and the matter of withdrawing funds is not satisfactorily attended to. Keen competition exists for deposits and the margin of profits is generally very narrow. They lend on immovable landed property or personal security and conduct ordinary banking business. Some of the loan companies are already finding it difficult to keep funds safely employed at interest for most of them do not possess more than one office. The small local, autonomous and independent banks and loan companies keep scattered reserves and unless they are also included in the banking reorganisation the efficiency, economy, and safety of centralised reserves would not be forthcoming. The constant failure to achieve any substantial and useful purpose except that of declaring successful dividends is due to the disorganised condition of the loan companies.

Proposed Lines of Action.

To secure improved banking safety and the provision of sufficiently varied facilities both internal and external machinery must be devised. The internal line of action consists in putting an end to the disorganisation and unco-ordinated action on the part of the loan companies which are very tenacious of their existence. The amalgamation movement gives the clue to the necessary action that has to be taken to cure the evils.

The external line of action consists in setting up a Central Bank of Issue which can make its reservoir of credit easily accessible to the better organised and more carefully managed amalgamated units. Both the above lines of action are fundamental and the internal problem is even more important than the external and brooks no delay. Without such previous preparation the creation of a Central Bank of Issue would leave these structures as they are at present. Unless they become respectable and conservative concerns specialising in an intelligent manner either short-term or long-term loaning business thus becoming more rational in the distribution of their risks, the Central Bank of Issue which would essentially be a bankers' bank would have

nothing to do with them. A Central Bank will agree to deal with banking institutions conducted on well-regulated business principles.

The Example of the United Kingdom.

A glance at the progress of the English banking system reveals the trend towards amalgamation and reduction in numbers as a marked feature of the past few years. The rapid and epic development of banking amalgamation in the United Kingdom represents a series of triumphs. Without any violent attempt to eliminate healthy rivalry and desirable competition the movement has ended in creating a very small number of large and powerful banking concerns.

Different economic causes operated to produce this drive for banking amalgamation.¹ The stimulation of the important economic causes such as increasing business was responsible for the country banks to amalgamate with the London banking concerns. The over-expansion of a few concerns made them consider amalgamation as a proper means of securing an outlet for their huge loanable funds. Circumstances of many kinds operated to initiate and spread this movement. The Government of the United Kingdom have on the whole consistently adopted a favourable view and permitted all cases of amalgamation which would not injure the interests of the country or the investing public.

The Concentration Movement in Germany.

Even in Germany the necessity to strengthen and extend the exceptionally weak foundation of capital and credit forced the pace of the amalgamation movement. The main principle of banking, viz., the distribution of risks is the foster-mother of this movement. The business of issuing securities accelerated the pace of the movement and the Berlin Banks strove to gain the custom of the provincial bankers. Misguided Stock Exchange legislation, Stamp duty, etiquette and competition forced the German Banks to establish their branches, increase their capital, and the concentration movement was fostered by these non-economic forces as well. The economic power of private banking to

¹ See J. Sykes, "The Amalgamation Movement in English Banking," pp. 16, 17, 45, 46, 92 and 93.



cope with increasing trade and industry was restricted and this acted as a cause in hastening the movement towards the bank amalgamations. The crises of 1873 and 1900 in Germany pointed out the necessity of efficiently-managed banking institutions. The large banks which intervened effectively soon absorbed the smaller and weaker banks. We cannot enter here fully into all the causes, economic and non-economic, that brought about the amalgamation movement in German banking.¹ But the main result is that as in industry the forms of cartels are protean so also there are bank affiliations, working agreements and complete fusions.

The Results. ✓

The happy result of such movement in both countries has been the improvement in banking technique. Reliable and competent management has ensued so that economic benefits have been reaped in most cases. Credit resources have been pooled and extended to more efficient men than before who are able to make a scientific allocation of credit for productive purposes. Progress, economy, strength and prosperity have been the chief results of the movement. A desire to realise these advantages is also visible in the American Banking system and several amalgamations have recently occurred in the American banking field.²

Impossibility of Amalgamation with Bigger Banks.

The weaknesses of the present-day loan companies are admitted by all people. There are only two ways of remedying the weaknesses: (a) by mending them, (b) by ending them. The latter alternative cannot be thought of as it leads to the shrinking of the credit structure. Amalgamation with the stronger banking companies cannot be thought of for the bigger banks would not care to consolidate their position by amalgamating with such bodies as those who resort to comparatively long-period loans on the security of real property. The bigger banks usually follow a cautious policy of lending on first class liquid securities. This tendency to tie up the resources would lead to failures and so long as the policy of borrowing short and lending long is persisted

¹ See Dr. Reisser, "The Grossbanken," pp. 602-702. &

² See the *Literary Digest*, May 25, 1929.

small banks
They should adopt modern business methods + amalgamate with

in there can be no thought of amalgamation as a remedy. Larger and better-managed banks are essential to finance the existing and the would-be expanding needs of agriculture, trade and industry.

How can the essential needs of developing the credit resources of Bengal so as to cope with the demand on the other side be met without changes in the credit situation? The revivification of industry and trade and rural economic organisation depends on adopting this movement.

The Main Advantages.

The reduction of costs even if the branches of a large bank are separated over the whole province would be a desirable end by itself. Additional deposits can be secured by the larger banks. With augmented resources propaganda can be carried on by the banks for tapping the small individual and dormant hoards. They would be in a position to meet the competition from rivals abroad. The evils of present-day unfettered competition among the loan companies must be realised and the best way of coping with the situation is to co-operate. Better organisation of the technique, perfecting the services to depositors and borrowers, extension of credit facilities to all deserving people and the introduction of rational business methods and accounting by a competent and trained staff are things which the larger banking units alone can hope to accomplish. The standardising of interest charges, commissions, and fees for services to customers over the whole of the province can be considered as the most outstanding gain of the amalgamation movement.

Other Expected Advantages. ✓

It would furnish a basis for the establishment of branches. There would be the much-needed decentralisation of activities of some of the overgrown loan companies. The more or less unsuccessful of the loan companies can hope to accomplish more by an amalgamation with the more successful ones. The larger banking units can create adequate credit resources that are needed if a unified programme of developing trade and industry and promoting the general economic interests of the province is drawn up. A

host of scattered medium-sized loan companies would accomplish very little success in the above direction. The extension of cheque business and clearing facilities would lessen the need for cash payments and promote increased freedom of action in the money market. Larger banking units can place better and more reliable credit information in the matter of bills, payment and foreign exchange than what the smaller loan companies can afford to place at the disposal of their clients.

The decline of the indigenous money-lender's importance may also represent another desirable consummation to be striven for by every well-wisher of the country. At any rate the opportunity of building up private money-lending business would be restricted. The amalgamated loan companies can easily widen the approach to the possession of a banking account.

The social obligation towards employees can be better attended to by the larger units than the small individual banks. The present average salary paid to the clerks of the loan companies is far too inadequate for the service rendered by them and if we are to free them from temptation to misuse funds all financial worry and anxieties are to be removed by paying a fair wage for fair out-turn of work. For the present there is no abuse and exploitation of unpaid apprentices which the larger banks of the metropolis (Calcutta) are at present doing. The Institute of Bankers can get better regulations of service recognised by the amalgamated banks.

A steadier rate of dividend and increasing size of customers would have its psychological effect and the amalgamation movement would doubtless gain further momentum. The press and the public can easily influence the policy of the larger units than an indefinite number of small scattered banking units. The amalgamated banks can keep alive and efficient certain key industries which are important to our national existence and even at the cost of some economic considerations the stimulation of such key industries is essential.

Unwholesome and unnecessary competition with the co-operative movement has tended to retard its growth and the co-operative movement of this province has not progressed so favourably as in the Punjab, Bombay or Madras. In spite of diversified activity in the

field of non-credit, co-operation such as in the matter of production, irrigation, anti-malarial societies, sale depots, rural reorganisation societies and other manifold purposes, the financial resources at the back of the credit aspect of the co-operative movement would have been far larger than is the case at present. This is a sheer loss of energy and waste of money.

The amalgamation movement would easily extinguish and absorb that is objectionable and dangerous in the haphazard and ill-balanced loaning methods of the present small-scale banking establishments. The present tendency to combine both short-term credit and long-term credit without adequate preparation to meet the depositors' call is wilful negligence of the sound canons of commercial banking.

There would be increasing development of demands on the part of the Government, the municipalities and the District Boards, etc., for capital. Hence greater banking units are essential and the evolutionary trend of development in international and foreign banking points out this tendency. It is taking place elsewhere rapidly in a reasonably orderly manner. Bengal has to move with the times. It must move with the stream or be left behind.

Such then is the brief outline of some of the advantages arising out of the amalgamation of the loan companies of Bengal.

Can the proposed Bengal Federal Bank stem the tide ?

The formation of the Federal Bank for the loan companies is indeed a less drastic remedy than the adoption of the amalgamation movement which can only be accomplished over a long period of years and perhaps with doubtful results if it is not carried out in the proper way. Preserving the complete internal autonomy of the loan companies the Bengal Federal Bank offers a less violent change in the banking reorganisation than would occur if the amalgamation movement is to be encouraged. Whether they exist as at present as small independent bodies or become welded into large units, it is essential that they should pursue vigorous advertising campaigns for deposits and provide at the same time convenient facilities for withdrawing the same and take adequate precaution for protecting

Further, the Federal bank should have the same rights

the deposits. Can the Federal Bank be considered a substitute for sound banking practice?

The essential idea of the Federal Bank itself is to secure a loose combination to expand and regulate credit facilities for the common pursuit of interests such as promotion of trade and industry. I would substitute absolute and complete fusion of the different loan companies operating at the different centres into one big bank, and at the top there would be the Central Bank of Issue and direct access to it would not be denied to such real banking concerns instead of the present money-lending concerns as they tend to become as a result of unenlightened management.

Unwholesome competition is a great evil and with greater resources, secured by access to the Federal Bank, they would still further compete so that the axe may fall even on the most efficient. Which is preferable—stagnation, slow and painful process of extinction or the resurrection, reconstruction and rationalisation of the banking business arising out of amalgamation? Of what avail is an overgrown, unmanageable and uncontrollable loan company finding it hard to maintain a productive investment of its loanable money? Some of the loan companies are finding it difficult to establish the equilibrium of the balance-sheet without sacrificing the liquidity of their assets. Unless a widening of this area of their activity takes place stagnation alone would be the inevitable result.

Is there any certainty and guarantee that accommodation will be made by the Bengal Federal Bank without undue favouritism? It is not only essential that the Bengal Federal Bank should pay due heed to intrinsic soundness of the borrowers' security but the due claims of other member-borrowers would have to be borne in mind. Would there be this impartial attitude in extending credit to different member banks? Would there be ample resources at the back of the Bengal Federal Bank to bring about a just, equitable and adequate distribution of the same amongst the different member-borrowers? The Bengal Federal Bank should attract long-term deposits also in addition to short-term deposits. As enough work can be found for both short-term as well as long-term resources, the Bengal Federal Bank should be capitalised on a big scale. Although it is proposed to grant loans to members alone and no dealings with the outside public are contemplated, still the demand for long-term credit would be

great. Short-term credit can be easily granted and as new avenues for it in the shape of demand for remittances, discounting bills, and making advances for financing crops or enabling the agriculturists to hold up their crops against low prices would be found, the nightmare of too large capital should not haunt the minds of the organisers. On the other hand, if it is under-capitalised, no appreciable results would be secured under any direction. Success is always on the side of big battalions.

An efficient system of supervision of the individual loan companies should be established as it is contemplated to advance small sums without taking any collateral securities from member-borrowers. It should act as a guiding, controlling and co-ordinating force so far as joint interests are concerned. The individual independence of the loan company is in no way assailed but the definite guidance and watchfulness of the Federal Bank would be of great help to them. The individual small loan companies can secure ready financial support from the Bengal Federal Bank. As an emergency arrangement it would prove very suitable for weathering any financial disturbance arising out of depositors' nervousness. But as a permanent remedy for all the evils that loan-companies are at present subject to it is doubtless inferior to a Central Bank of Issue. This is far more preferable to the starting of a Federal Bank for loan companies alone. In case of the Central Bank of Issue, the Act of Incorporation may be specifically framed so as to forbid discrimination in favour of or against any member-bank. The aim of a Central Bank is to aid all branches of economic activity, the producer, the manufacturer and the farmer with absolute impartiality. Its elastic note-issue would enable it to meet the legitimate demand for genuine credit expansion. Its periodical scrutiny of the member-borrowers' position would tend to elevate the standard of banking into a higher plane. Its greater strength, authority and scope would enable the Central Bank to bear any additional burden and if the larger loan companies co-operate with the Central Bank of Issue the problem of banking reorganisation would be easily solved.

Why not Depositors as Directors?

Although the Bengal Federal Bank is to be a bankers' bank, individuals are permitted to own shares and be elected to the Board of

Directors of the Bengal Federal Bank. Though the constitution of the Board of Directors would be of a mixed type consisting of individuals as well as representatives of loan companies it might fail to inspire the depositors with any amount of confidence. Throughout the history of Indian banking the most noticeable feature has been the lack of confidence which the depositors always evinced at crucial times, with the result that even sound and solvent bankers who committed the fault of locking up short-dated deposits in long-dated loans came to grief. Doubtless many depositors would be attracted towards the Bengal Federal Bank and it should boldly come forward and secure legal permission to incorporate the following suggestion. Directors can be elected to represent the depositors and if these sit on the Board of Directors, the depositors would feel some sort of protection and as this matter can be easily arranged no opportunity should be lost to adopt this salutary practice in the Federal Bank's operations after securing the necessary legal permission to do so. As the present Indian Companies Act does not permit any other than a shareholder to be a director, this innovation cannot be secured, but if the Federal Bank seeks a separate charter of incorporation containing this special feature as one of its statutes, it would go a long way in pouring oil on troubled waters.

The Bengal Bankers' Federation.

Thus far the advantages flowing out of the activities of the Bengal Federal Bank and its inferiority to our suggestion has been pointed out. Coming now to the non-financial activities of the Bengal Bankers' Federation, the following aims of the same should be borne in mind.

The Aims of the Federation.

Broadly speaking the main aims of the newly started organisation are threefold in number. Firstly, it is proposed to form a permanent and authoritative organisation for the constant review of all aspects of banking and promote its development on sound lines by inculcating measures leading to the wide diffusion of banking knowledge, by initiating or securing legal measures conducive to the best interests of the

indigenous banks and their business, by adopting uniform and standardised forms of contracts, etc., and promoting banking intercourse among practical bankers and others interested in banking. Secondly, it aims at the elevation of the technical knowledge of bank officers in actual charge of practical banking business, thereby lessening the scope for bank failures due to inexperienced or injudicious banking. Thirdly, it proposes to found a bankers' bank which would be of substantial use to the banks and loan companies of Bengal and ensure the free flow of capital from the metropolis to the mofussil and *vice versa*. Another laudable object is to promote the continuous investigation into banking problems of our country and publish the results of these investigations and other facts bearing on all problems that concern banking business, so as to guide the people conducting practical banking work on sound and unimpeachable lines. Still another function which would add to the material progress of the province is the attempt to organise stock exchanges in prominent centres and promote the investment habit on the part of the people.

General Long-period Effects.

A cursory glance at the different aims of the Federation would reveal the fact that if it is successfully worked and if concrete and decisive action is taken according to the plan, it is bound to have a beneficial influence on the financial progress of this province. It is nothing but a co-operative effort on the part of banking experts and practical people in touch with banking to prevent mismanagement of banking business often resulting out of incompetency or ignorance. The proposed object is to prepare the ground for co-operation between the different isolated banking and loan companies working in the interior of the province and enable these loan companies which roughly number about 600 to take concerted action in common matters which may affect them vitally. The best form of credit policy and financial organisation needed for the province can be created as a result of its deliberations.

It has become indispensable in every walk of life, be it money-lending or business endeavour or pleasurable undertaking, to co-operate with each other and establish a joint permanent organisation for the purpose of securing the desired ends and aims. If a

new banking era is to be started in the province it is high time that this Federation should be recognised officially.

Business efficiency and business statistics in the field of banking would not be forthcoming without the assistance of such a federation as this. Effective publicity and presentation of banking statistics in place of present secrecy would create stability and confidence. Like the British banks, the Indian banks lag far behind the American banking institutions in the matter of publicity.

The Bengal Bankers' Federation should follow the American banking practice and seek to publish its facts and figures. Banks like other institutions do not stand to gain anything by placing their light under the bushel. It should likewise follow some of the salutary measures adopted by the American Bankers' Association in the development of agriculture.

The necessity of active propaganda and continuous action must not be ignored. Many of the Agricultural Associations of Bengal are in a state of suspended animation. Better banking knowledge, better banking services and better financial facilities are essential. With reference to the provision of common aims such as better banking knowledge it is its bounden duty to co-operate with the All-India Institute of Bankers which was started just the other day at Bombay under the ægis of the Imperial Bank of India.

Difficulties in the Path of the Amalgamation Movement.*

Lest I might be accused by the promoters of the Federal Bank for light-heartedly advocating an ideal altogether different from theirs, it is my bounden duty to point out the difficulties in the way of realisation of this amalgamation movement.

The movement would indeed be of slow and gradual growth and in the first instance it should be confined to the union of all loan companies in one and the same local area. There would be difficulties, complex questions and burdensome details which would have to be solved in the matter of securing the desirable consummation. Given an enlightened leader the process can be discussed and arranged for and success can be achieved. By holding conferences the directors can appreciate and learn the basic facts of the situation and if specialists are consulted the question of fusion would no

doubt be easy. Concentration in banking is always easier than in the case of industrial companies and their different plants and establishments. Sound leadership, breadth of vision, a spirit of give-and-take and desire to collaborate and the placing of more reliable information by the present over-secretive directors are essential for the success of the movement. The satisfaction of share-holders can be easily arranged when proper valuation and conservation of the investments are made by the promoters. The abnegation of personal jealousies and ambitions and the pursuit of general good are essential to carry out the amalgamation movement. The inherent good sense of the share-holders would not fail to make them realise the consequences or the end of the amalgamation itself. The state can facilitate the movement in many ways. Stamp duties may not be charged whenever a mere re-incorporation of the loan companies is made under a new Company. When fresh capital is attracted the stamp duty may be levied. Special rebates and allowances were granted in Germany to enable the steel merger to take place. In some cases the previous British Governments allowed similar concessions in case of industrial combines, *viz.*, railways and mines—in England. Such a favourable attitude would undoubtedly facilitate the progress of the movement.

Conclusion.

A good impetus can be given to banking and all other industries dependent on it by a sympathetic handling of this idea. It is only by such an enlightened policy that the long-term credit needs of landlords can be met in this province. Several of the larger or amalgamated loan companies can specialise in mortgage business and with some amount of caution conduct successfully this land-mortgage banking as some of the joint-stock Land Banks are doing in the United States of America. Others might elect to specialise in short-term loans to agriculture, trade and cottage industries of the localities. Unless there is specialised attention and rational and systematic division of labour in the matter of credit facilities by each reorganised larger loan company, the cry for state aid and state control over the present loan companies is irrational. Greater functional

specialisation among the larger loan companies affords the proper key to the solution.

Frankly stated there is not much immediate justification in organising co-operative land mortgage banks for long-term credit, because the landlords make little demand for long-term credit for agricultural improvement purposes and this they cannot do in the near future even, so long as there are co-sharers in land. Advancing credit in competition with the present loan societies is dangerous. It would undoubtedly lead to the granting of unsound loans and undue lowering of the rate of interest which may be beneficial to the borrower only if a right use of easy and cheap credit is made. It would, however, spell ruination to the competing institutions. Unless this whole situation is studied carefully the starting of the co-operative land-mortgage banks should not be thoughtlessly done. Theoretically speaking the organisation of long-term credit tending to reduce the rate of interest would be a boon to the owner-agriculturists but in Bengal at present this is not immediately possible or feasible. Our serious endeavour should be in the first instance to study the present-day position of the loan companies of Bengal and give them a recognised and useful place in the credit system of this Province. It is sheer folly to force this private enterprise out of business by starting a brand-new organisation. It is the unsatisfactory state of these small banks and loan companies that makes one suggest banking legislation and enforce it by public inspection. It is the mistakes of these that recoil on the head of the bigger joint-stock banks however prudently they might be conducting their practice.

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CHAPTER IX

THE INDIGENOUS BANKER OF INDIA

The etymology of the word "bank"—The meaning of banking—The development of banking in Europe—The origin of banking in India—Lack of data and precise knowledge—The past status of the indigenous bankers—Contact with Western civilisation—Several names of the indigenous bankers—Functions of the indigenous rural bankers—Comparison of their money-lending policy with Western banking methods—The banking habit—The shroff or the urban banker—Rediscounting traders' bills—The native bazar rate—Non-credit functions of the indigenous bankers—Organisation of their business—Their public spirit—Indigenous bankers' associations—Is it wise to deprive the shroffs of deposits?—An elastic system of moral credit—Educate the rural borrowers—The present position of the indigenous banker—Defects of the indigenous bankers—Why has the indigenous banker failed to become a modern banker?—Suggestions for improving the indigenous banking system—Other quasi-banking institutions—Their future.

The Etymology of the Word "Bank."

The terms "bank" and "bankers" are quite modern but the profession is an old and time-honoured one.¹ The word "banck" was a German term signifying a joint-stock fund. The Italians used the word "banco" meaning a heap of money or an accumulation of stock. The common derivation of the word 'bank' from the counter upon which the Italian money-changer used to lay out his stock has been ridiculed by H. D. MacLeod on the ground that the Italian money-changers as such were never called "bancheiri" in the Middle Ages.² Whatever might be the real origin of the word 'bank' we see that the etymology of the word suggests an origin which would trace the history of banking in Europe from the Middle Ages.

¹ According to the French writer M. Revilpout there were banks and bank-notes in Babylon six centuries before the time of Jesus Christ. See B. Nogaro, *Modern Monetary Systems*, p. 163, footnote.

² H. D. MacLeod, "Theory of Credit," Vol. I, p. 90.

The Meaning of Banking.

Originally banking had its origin in the efforts of individuals to supply certain primitive wants of an advancing community, namely, lending and receiving deposits. The process of satisfying their wants was by means of a few perfectly simple operations. But with the evolution of time these individual wants soon sank into insignificance and the unforeseen, much disputed and ulterior effects of a banking system became recognised. The primary and original functions of banking namely lending and receiving deposits are still the more important functions but a great variety of services are performed by modern banks and with the advent of specialisation due to the progress of society we find a diversity of banking operations, as well as institutions. It has fallen to their lot to finance industries, to liquidate the international indebtedness, to manipulate the currency system and lastly to mobilise credit which furnishes the life-blood of trade and commerce. It is futile to catalogue the range of facilities offered by modern banks to the community nor is this the proper place to indicate their limits.¹

The Development of Banking in Europe.

According to C. A. Conant the forerunners of modern bankers were "the individual money-changers, the Jewish money-lenders and the Lombard bankers." As industry expanded by leaps and bounds, as centralised government emerged out of the welter of political chaos and as national life became organised the necessity for public banks arose. The Bank of Amsterdam was organised to remedy the defects in the currency circulation of Holland. The Bank of England would not have been ushered into existence so soon but for the necessity to finance the Dutch Wars of William III, King of England. So European banking understood in its modern sense is barely three to six centuries old. But India on the other hand had a widespread banking organisation some centuries before the modern term "bank" had been coined.

¹ For a brief enumeration of the important economic services of banks see my "Elementary Banking"—Section on Economic Services of Banks.

The Origin of Banking in India.

Evidence is forthcoming in abundance that the business of banking was perfectly understood by the people of ancient India and fairly practised by them. In early times the guilds or individuals issued coins as well as credit instruments. Dr. S. V. Ketkar speaks of eighteen guilds of different trades and the Mahasethi arbitrated in matters of dispute between the different guilds.¹ Dr. Pramathanath Banerjea quotes from Gautama, Brihaspati and Baudhayana verses which regulate the rate of interest.² The Institutes of Manu give us rules regarding the regulation of interest and the policy of loans.³ Kautilya offers some interesting advice on these points.⁴ Sir W. W. Hunter gives us valuable information as to the manner in which a private banker sets up his business.⁵ The practices of the village bankers of the early part of the 19th century are dealt with in detail by A. F. Tyler.⁶ Mr. Thorburn describes vividly the 'greed of gain' on the part of the village "bunniahs"⁷ of the Punjab and the methods of operation which tended to reduce the agriculturists into a state of "prædial slavery." Some glimpses of the indigenous system of money-lending and banking can be obtained from Mr. Malabari's account of Guzerat.⁸ Sir Richard Temple testifies to the fact that banking business was carried on by our ancients. He estimates "the number of bankers to be one hundred and eighteen thousand males of which some are money-changers. There are half-a-million of villages and there are about two bankers to every village."⁹ The recent Census of India estimates the number of

¹ See S. V. Ketkar, "History of Caste in India," Vol. I (1909), p. 38.

² See Dr. P. Banerjea, "Public Administration in Ancient India," p.

³ See Burnell and Hopkins, "Ordinances of Manu."

⁴ See Kautilya's "Arthashastra," see R. Sham Sastri's Translation, Book III, Chs. XI to XIII.

⁵ See Imperial Gazetteer of India, Vol. IV.

⁶ See "Considerations on the Present Political State of India," 1815, 2 Vols.

⁷ S. S. Thorburn, "Mussalmans and Money-lenders of the Punjab," Ch. VII, pp. 54 to 72.

⁸ See his "Guzerat and the Guzaratis."

⁹ Sir R. Temple's Lecture before the Institute of Bankers, London; Journal of the Institute of Bankers, Vol. II, 1881.

bankers to be about 1,461,000, but it includes bank managers, money-lenders, exchange and insurance agents and money-changers.”¹ Speaking of their locale it remarks that “Banks and money-lenders are plentiful in the Punjab, their number exceeds the general average in Bombay, the Central Provinces and Berar and is somewhat below it in Bengal, Madras and the United Provinces, while in Assam it is only 1 per mille.” Epigraphic evidence as regards the prevalence of banking in ancient India can be cited from the pages of the Indian Antiquary. Dr. Radhakumud Mukherjee cites both literary and epigraphic evidence as regards the prevalence of banking in ancient India.²

Lack of Data and Precise Knowledge.

Barring a definite exposition of the organisation and methods of banking and money-lending no analytical method of study and practice of the indigenous banking system can ever be written as there are no published figures of their operations. No accurate knowledge and real understanding of the precise issues solved by the indigenous bankers can be forthcoming due to paucity of materials. No statistical information of their business has been collected by the previous rulers. Even now the situation is not improved to any extent. The lack of political tranquillity for a number of years must undoubtedly have told very seriously on the banking houses in the different parts of the country. The indigenous bankers plied another occupation, notably that of merchant or trader and shop-keeper. Investment in real estate was the most common occupation in addition to banking business. A *banker quâ banker* did not exist in the past. Even now the situation is not wholly changed. It is seldom that they restrict themselves to ordinary banking business. They perform a multiplicity of operations and this renders difficult the study of the methods of the indigenous bankers. The word banking is loosely used in the sense of mere money-lending even upon security, real property, agricultural produce or industrial products.

¹ *Vide Census of India, 1921, Vol. I, Chap. on "Occupation."* The previous estimates in 1901 and 1911 were 1,156,000 and 1,128,000 respectively.

² See Dr. R. Mukherjee, "Local Government in Ancient India."

The Past Status of the Indigenous Bankers.

Many of the indigenous bankers held high political authority at the Mogul Courts, specially towards the closing years of the Mogul regime. The advent of the British rule has no doubt deprived him of his political importance and prestige. The political influence of Jagat Seth¹ and Omachand during the Plassey days is well-known to students

¹ *A Brief History of the House of Jagat Set.*—The founder of the house was a Marwari Rajput who immigrated from Jodhpur somewhere about 1695 and settled in Patna and began money-lending business. His seven sons migrated to different parts of Bengal. The eldest son Manik Chand migrated to Dacca and became the Court financier of the Dewan Murshid Kuli Khan, the founder of the house of Murshidabad, and to him was entrusted the task of remitting Bengal's contribution to Imperial Delhi. In 1715 he was given the title of Seth. His adopted son "Fatechchand" was given the hereditary title of "Jagat Seth" or the "banker of the world." Fatechand was a member of the Council of Shujahuddin Khan and was largely instrumental in installing Alivardi Khan in the place of Sarfaraj Khan who insulted the honour of a lady of his house. The next bankers to control the firm were Mabbat Rai and Swarup Chand. The finances of Bengal lay in their hands. "The pay of the army and civil administration depended on their honouring the orders for payment made by the Nawab. They stood security for revenue farmers and regulated the rate of exchange, being, according to a letter sent by the Calcutta Council to the Court of Directors in 1753, the sole purchasers of all the bullion imported into Bengal." Orme says that "the French East India Co., at Chandranagore was indebted to them to the extent of 1½ m. of Rupees. He also states that Alivardi Khan received a present of 3 ms. of Rupees from the Seths as a contribution to support the expenses of the Maharatta war." In the year 1742 they felt the first stroke of ill-luck when a Maharatta horde—part of Bhonsley's—defeated army at Burdwan, swooped down on the House of Jagat Seth and carried away two crores of Arcot Rupees. In spite of this loss they carried on their banking business and in 1749 they lent the English 12 lakhs of Rupees. From this date their influence is to be noticed in the affairs of the English E. I. Co., in India. Nawab Surajdaula, on account of his cruelty and injustice, soon became unpopular and fell out with his banker the Jagat Seth who refused to raise three crores of Rupees from the European merchants. His openly insulting him in the Durbar led to the latter's intrigue with the English officers of the East India Co. According to the French writer, Law, the Jagat Seths were so powerful that they could have installed a new Nawab on the throne without the help of the Europeans but as time was of importance the Seths who feared the confiscation of their wealth had to join hands with the English who were anxious for their very safety. It was in the house of Jagat Seth that Watts, Walsh and Shrafton met with the ill-fated Aminchand to work out the details of the plot by which Mir Jafar hoped to obtain the Subaship of Bengal. The Jagat Seths continued to flourish under the new Nawab and their relations with the English became more friendly. When Jagat Seth visited Calcutta in 1759 the English entertained him at a cost of 12,000 Rupees.

When Mir Kasim came to the Musnud he did not tolerate the friendship of the English and after the recapture of Patna from Mr. Ellis he drove every Englishman out of his dominion and conveyed the bankers to Monghyr. When he was completely defeated by the

of history. The Seths of Madura exerted much influence on the political history of South India. Historians have recorded that these bankers granted loans to rulers and financed their long protracted wars. Every Native State had its banker who took active part in the financial administration of the Prince's territories. The indigenous bankers continued to play their usual economic role in financing the internal trade. Some of them financed the wars of the E. I. Company² and till the European Agency Houses and merchants successfully settled in the country the coastal trade of Bombay with Arabia and the South African territory was financed by the indigenous bankers of Surat.³ Many of these old houses have disappeared and the modern indigenous banker finances the internal trade of the different provinces and plays an important part in the financial organisation of the money markets in the different cities. They are the recognised money-lenders, money-changers, bullion merchants and financial middlemen.

Contact with Western Civilisation.

With the advent of Western business methods the cultural superiority of the indigenous bankers began to decline. New institutions such as the Civil Courts, the Laws of Contract and Limitation and the legal practitioners soon gave scope to the indigenous bankers or

English at Jheria he got his European prisoners shot down by his soldiery. Ramnarayan of Dacca was cast into the river. Raja Rajbullub was put to death with all his sons and after draining away the wealth of Jagat Seth he ordered him to be thrown into the Ganges from one of the bastions of the Monghyr fort. In spite of the survival of a few connections here and there the house of Jagat Seth decayed until there now remain but the ruins of the beautiful Jain and Hindu temples of marble and porcelain, the old Indian mint and the mere skull of that once princely dwelling of these bankers in the vicinity of Mohimpur near Murshidabad, the capital of the Nawabs of Bengal. (The details are gathered from Selections of the Calcutta Gazette, Orme's History of Hindusthan and O'Malley's History of Bengal, Behar and Orissa. Some of the recent writers who have slavishly followed his outline do not have the courtesy to mention his name once even in a footnote.)

¹ The Nagerseths of Bengal financed the local Nawabs. The Peshwas of Poona were financed by the indigenous bankers.

² One Bansilal Abechand financed the Government of Bengal during the days of the Great Sepoy Mutiny of 1857.

³ A detailed history of the House of Arjunji Nathji of Surat would be presented in my monograph on "Organised Banking in the Days of John Company."

the depraved money-lenders to exploit the peasants and ryots who did not know how to make a fair use of the rights of occupancy and ownership conferred on them. Money-lenders soon degenerated into land-grabbers and the pristine honesty and scrupulous regard for truth soon became dimmed by the more materialistic tendencies that have been introduced of late into the calm and placid atmosphere of our social life. Noticing this vicious change Sir R. Temple rightly remarked that "the passing of the English law of bankruptcy has demoralised the native bankers of the Presidency Towns."¹ Throughout the nineteenth century and in the first two decades of this century new rival financial institutions were being created with the result that the indigenous bankers find their sphere of business restricted. They are fast losing their prominence but they are making no efforts to adapt themselves to the altered circumstances of the day. Instead of developing into modern bankers pioneering corporate financial activity, they prefer to conduct "mixed" banking business in the same old traditional style. Solidity and economy are no doubt prominent features of their banking business but they are lacking in adaptability and initiative which characteristics also a sound banking system should possess.

Several Names.

The indigenous bankers of India are known by several names in the different parts of India. The most common names are saucar, bunniah,² chetty, nanavaty, mahajan and shroff. The well-known

¹ See Sir R. C. Temple, "Lecture before the Institute of Bankers," 1881, Vol. II (Journal of the I. of Bankers).

² In the earlier days of the E. I. Co. the native manager of an English Agency House and of a ship captain was called *Mutsaddi* by the natives and *banians* by the Europeans. The Banian was really the factotum of houses and captains and due to the absence of any European banking establishment had the sole charge of their monetary transactions. The native agent was necessary as the goods of the Co.'s Officers could not be sold directly to the natives on account of the ignorance of the native's language on their part. High-caste Hindus refused to act as banians as the investments of the Co.'s Officers usually included wines, liquors and other provisions which could not be touched by the high-caste Hindus. A washerman of Colootolah was entrusted with the duty of selling the investment and this dhoby gradually set up a partnership with three other friends to manage the sale business. Seeing the lucrative nature of their business legions of high-caste Hindus appeared [to act as *dobus* to the captains of the ships and the name *dobus* was changed to Banianship.

indigenous banker often referred to as the bunniah or saucar has almost become an indispensable figure in our social organisation and a necessary factor in the agricultural economy of the country. His position in the financial circles of the Presidency Towns is unique and here he is often referred to as the shroff.

Indigenous banking business is purely a family concern and has become a hereditary calling in particular castes or classes of society. Almost all members of this caste or class possess fairly good business knowledge. They are remarkably astute and frugal in their habits. They have a special natural aptitude for earning and saving money. Generally, no new ideas appeal to them. Their conservatism and traditional resourcefulness are undoubtedly strong assets and save them from many a bad debt. While the smaller money-lenders can be considered as a set of low usurers, the more wealthy of these indigenous bankers are private capitalists owning magnificent sums and though they are often averse to the principles of joint-stock banking they form private partnerships under the management of the senior partner. They seldom reveal their transactions to the public and it is only when these firms occasionally fail that the general public know the real magnitude of their operations.¹ They are most courteous to their customers. They entertain their visitors with great intimacy and much friendliness but are very reticent or maintain strict secrecy regarding their business affairs. Very often in the old days they were appointed as trustees for village endowments and the management of these lines of property tended to increase their business knowledge, pecuniary resources and social status.

But the one great defect of the private banking business of the indigenous banker is that it is usually hereditary in the family. A man who originally works the private bank may be a good banker,

After the abolition of the Co.'s monopoly several of the identical banians served them again as their merchants and agents. (Selections of the Calcutta Gazette and Carey, "Hon'ble the John Company.")

¹ The failure of Sobaram Paul and Cossinath Paul, a house of 20 years' standing, regarded to be the oldest shroffs in Calcutta took place in 1838. "Their transactions often amounted to several lakhs of rupees but the failure was limited to about a couple of lakhs and was forced upon the acting partner Cossinath by a quarrel with his brother about their joint responsibility for losses on opium that year which the latter was supposed to have ample means of making up." See the Asiatic Journal, June, 1838.

financier and businessman, but it does not always follow that his son who in all likelihood and certainty inherits this business will be capable of running it. The private bank wants continuity of able talents in the family. It wants continuity of young men coming on who are willing to work and who have the ability to work successfully. It is difficult to find that all these factors are satisfactorily obtained in a private bank. The efficiency and driving power which are to be found in joint-stock banks are seldom visible in these private banks. The joint-stock bank is not handed down by the deceased father to his son but is always under efficient and capable management. This is one feature that is telling heavily against the indigenous bankers. The verdict of history has gone against them in England and the Western countries but the indigenous bankers show no sign of speedy extinction. The starting of the co-operative credit movement is itself a grave and serious warning that they have outlived their period of usefulness and if, at this time, when the general banking machinery of the country is being reorganised, they refuse to become serviceable in the direction of establishing a real money market in the country an attempt would be made to exclude them altogether from the national credit economy of this country. As soon as the other superiorities¹ of joint-stock banking over private banks are appreciated the present scope of the private bankers would become circumscribed and may even be superseded by them.

Functions of the Indigenous Rural Banker.

The indigenous banker is a dealer and broker in capital. His main business is to lend money. It is not purely a case of personal security that he likes but the indigenous banker is the most inquisitive person of all mankind and the customer has to give him his free confidence. Since some of the loans are generally for performing social functions or other unproductive purposes he takes good care to

¹ The increased security from paid-up capital, exclusive employment of it in banking business, the support which each shareholder can personally render to the establishment, publicity in its affairs, reduced charges at which a Company broker for a moderate dividend can afford to conduct business, the consistency with which it conducts its business and the liberal assistance it can offer to its customers are some of the technical superiorities of joint-stock banking over private banking.

take collateral securities to balance the amount of his loan. He sometimes deducts interest beforehand and pays the outstanding balance to the customer. He takes care to collect the debts by instalments. His rate of interest is often very high ranging from Rs. 18 to Rs. 36 per cent., and he is so merciless in his exactions that he has been termed the Indian "Shylock." But there has been a marked fall in this rate of interest due to the competition of the co-operative credit societies and the increase in the economic stability and peaceful conditions of society under the British Rule. But for the worthless security of the ryots who may merely be tenants with no title to land and the difficulty of collecting the original sum loaned out which has also to be reckoned, the rate of interest would have been reduced to a lower figure than at present. The financing of agriculture is largely dependent on the monsoon. As this is a seasonal occupation requiring half-time employment for the money supplied by the banker, he is forced to charge a high rate of interest when it is employed. The same is the case with the shroff who is forced to charge high rates in the bazar during the busy season when he has to earn enough profit to enable him to pay the deposits that lie unemployed in his hands during the slack season. Undoubtedly there has been a weakening of his position and he is able to thrive only in the limited area of his business. As the co-operative societies are gathering strength and are beginning to work successfully, the mahajan or the bunniah is drawn into the vortex of the society. He supplies the capital as he finds better security and no risk and the co-operation of the mahajan is to be enlisted on a wide scale because he is the only educated person knowing something about banking and if his services are enrolled in the cause of the co-operative movement it will not only result in the elimination of a dangerous competitor and rival but will bring the aid of his expert knowledge to a just cause.

Instead of these rural bankers whose functions, though they may be many, are not so varied as those of the modern corporate banking institutions or the low set of users who lend money at exorbitant rates, a more sympathetic lending agency has to be created. Every one has to acknowledge that the nucleus of such an institution already exists in the co-operative credit society.

Comparison of the Money-lending Policy of the Indigenous Bankers and Money-lenders with the Policy of the Western Joint-stock Banks.

The commercial banks of other countries do not grant loans for long periods and lock up their funds in unrealisable assets. They never forget that all the assets of a bank should be within the quick and easy control of the bank. But the indigenous money-lenders do not conform their business to these principles. They lend money on every kind of security preferably land, real estate and jewellery. As most of the working capital is their own they are not afraid of any run. *But the mistake lies in the fact that they have not created any tangible instrument which would enable them to pass it on to the joint-stock banks.* The lack of such an instrument precludes or disqualifies them to act as an intermediary between the primary borrower and the ultimate lender, i.e., the joint-stock banks of the country. Any liquid paper backed by the endorsement of the indigenous banker should comply with the requirements of the joint-stock banks. By this method the indigenous banker can easily become the indispensable link in the banking chain which connects the farm or the factory with the modern bank. Lack of adaptability and initiative must be the sole reasons of his short-sightedness in this respect. ✓

Again the European banker weighs each debt by itself. Generally speaking he grants loans on sufficient collateral security placed in his hands and the indigenous money-lender balances good against bad debts. He distributes his risks among his various clients. When a higher and more tempting rate of interest is offered he willingly hazards the risks but of course he has the prudence to take some kind of security. So the necessity to write off bad debts is less urgent than in the case of the European banker and though the native banker does not lose his capital, he gets it locked up in real estate or other properties. So for sometime at least there is a temporary diminution of capital with which the business is run. The rural money-lenders and the indigenous bankers do not understand that "the banker should be a liveried stable-keeper who must keep his horse always ready for hire." He should realise that 'banks are made to make capital circulate, not to lock it up' as P. Leroy Beaulieu has said.

It is often stated sarcastically that the Indian money-lender's motive in granting loans is not a laudable one. It is the small

money-lender who generally trades on the misfortunes of his clients pampering them with fresh loans till they are over head and ears in debt.¹ The only way to extricate oneself from the money lender's clutches is to bid farewell to the mortgaged property. The like condemnation cannot be extended to the village banker of the better class who generally refuses to grant loans if there is not proper credit behind the borrower. The above description applies to the low set of usurers who are rapidly springing up everywhere as the diseased products of a diseased society. They consider that money-lending is the easiest way of adding to their capital.

The western banker will not allow his gold or cash reserve to remain permanently higher than what he considers necessary for the purpose of his business. To do so would amount to neglecting to take a profit in his business which could be safely secured and that is a course which the banker does not adopt. When the bankers' reserve is in excess of his requirements he lowers the rate of discount, issues credit to a greater extent and sees his reserve gradually reduced to that amount below which he considers it unsafe to allow it to fall. Owing to the ebb and flow of his business there may be at times a superfluity of gold at the banks or the reserve may fall below the safety limit but the guiding principle is that the supply of gold should be fully utilized. The indigenous banker on the other hand lays much importance on the rate of interest.

Money-changing.

The name 'poddar' was given to the banker who specialised in this line of exchanging of one kind of coin for another. In former times there used to be a variety of coins issued from a number of mints.² With the breakdown and gradual disintegration of the Moghul Empire the various Indian potentates set up their own mints and minted their

¹ According to a very widely accepted view the main cause of rural or agricultural indebtedness is "the vicious system of credit of the mahajan." "All the improvidence, extravagance, the costly marriage feasts or funeral ceremonies and the ruinous litigation are merely due to the fact that the village usurer is too willing to lend for these purposes." —There is much truth in this view for "cheap and abundant credit is always a dangerous remedy." *Vide* Indian Co-operative Studies, p. 35.

² According to MacLeod "There were 994 kinds of gold and silver coins of different weights and fineness whose value was constantly varying." Hence "attempts to force bi-metallism were a failure."—Indian Currency, p. 13.

own coins. This made the confusion worse confounded. The money-changers used the multifarious currency to their own advantage. The moneychangers were the contractors in the native states for the mint. Up till the year 1793, there was an endless source of trouble and disturbance due to the multiform native coinage. The East India Company began to mend matters but not until 1835 could a definite, well-recognised and uniform coinage be issued in silver. Up till this time the money-changers used to ply a lucrative business but now this source of profits has dried up.

Deposits.

The joint-stock banks are more borrowers than lenders. They attract other's money in the shape of deposits, part of which they utilise in granting loans and overdrafts. Even while discounting bills of exchange the joint-stock banks give the right to draw on them and this takes the shape of a book credit with them. The customer exercises this right by drawing a cheque to meet his actual needs or may allow the amount to lie idle in his current account balance in order to draw on it at a later date. Thus in advanced societies where banking is fully understood and practised, deposits arise in three ways: (a) by actual deposit of cash paid across the counter, (b) a bank loan makes a deposit, (c) the discounting of a bill of exchange may lead to a deposit. The loan of one bank generally becomes the deposit of another. Thus the banker succeeds in making the members of the community lend their savings either willingly or unwillingly and it is with such borrowed resources that he conducts his banking business.

The rural indigenous banker attracts very little resources in the shape of deposits. This is partly due to the fact that the banking habit has not taken hold of the people as yet. He makes no attempt to attract deposits but he certainly keeps the resources that poor people generally entrust to him for safe custody. He pays a slightly higher rate than the current rate of interest which the savings bank or the Joint-Stock banks of his locality may undertake to pay. He also stands ready to honour the cheques¹ with ready payment in case of

¹ Sir R. Temple records that the Indian people evidently of his times never drew cheques on the deposits they gave to the indigenous bankers. "It is a most extraordinary instance of the mutual distrust between man and man." But this has now changed and

current accounts. So far as their fixed deposits are concerned the depositors generally consider it a moral obligation not to embarrass the banker by making a call at any inconvenient time. The custom of paying fixed deposits before time whenever so required by the depositor might be seen in the case of the ordinary joint-stock banks.

There are some indigenous bankers who in the beginning of their career take much care to attract deposits but as soon as they build up a safe and attractive business they no longer care to burden themselves with the onerous duty of attracting deposits and be in a position always to pay them at call. These people consider deposits more a source of hindrance than help to them, so much so, that it has been asserted that some of the indigenous bankers have willed down to their successors never to take up the irksome business of attracting deposits.

Again many of the shroffs, *i.e.*, indigenous bankers, prefer to receive deposits from friends but not from businessmen. Full well do they know that money from business people is liable to sudden, frequent and untimely calls. So the indigenous banker does not make it a systematic policy on his part to advertise for deposits and attract them by paying a stipulated rate of interest agreed to at the beginning. Yet it would be quite wrong to assert that he does not make use of other's money.

To a very great extent the muffusil banker depends for money on his own purse and if he is in need of money he goes to a fellow-banker who lends him money at two to six per cent. rate of interest. It is only in the last resort that they go to the Joint-Stock banks for additional funds. Some of them view with hostility the rise and progress of these institutions but many of them have realised that they are a source of great help to them. Though in one sense they are rivals they confer inestimable advantages to the muffusil indigenous banker. They render unnecessary his keeping a large stock of silver rupees. They facilitate his remittances from place to place. It might pay him to deposit his idle cash and obtain the banker's deposit rate of interest. They help him much by discounting his hundies. The endorsement of the indigenous banker makes the hundi doubly

some of the bigger indigenous bankers consent to keep current account and permit people to draw cheques on the same.

strong and such a bill of exchange is a perfectly ideal security for the Joint-Stock bank to discount. Sometimes also a big line of overdraft is usually granted by the Joint-Stock Bank which would aid him substantially in all his operations. Thus the starting of more Joint-Stock banks and the extension of their branches in the interior of the country and at the different agricultural centres is a source of direct benefit to him. In many places the indigenous bankers are coming forward to help the starting of new Joint-Stock banks and extending branches of old and tried banking institutions. Undoubtedly it is in the interests of this country that progress in this direction should be accelerated. The Co-operative Banks afford the best solution and if this movement is encouraged on proper lines the rural credit needs can be supplied on more sympathetic lines than at present.

The Banking Habit.

The absence of the banking habit cannot be attributed solely to the indifference and apathy of the indigenous banker towards the deposits of the people. Nor is the want of security in the past the sole cause for the absence of the banking habit. The absence of savings banks or other institutions to store up savings, the frequent occurrence of famines and the poverty of the people must have had also retarded the growth of capital in India. The absence of a well-secured paper currency commanding the confidence of the community must also be held responsible for the absence of banking habit.

The rise of banking institutions, and the tolerable security arising out of the Pax Britannica gave great stimulus to the growth of deposits in our country. The following table shows the growth of deposits.¹

(Crores of Rupees.)

Year.				Presidency Banks.	Exchange Banks.	Joint-Stock Banks.	Total.
1887	...	...	...	11	4	1	16
1890	...	...	...	18	7	2	27
1897	...	...	...	12	9	6	27
1907	...	...	...	31	19	14	64
1917	...	...	...	75	53	32	161
1919	...	...	...	75	74	61	211
1920	...	...	...	86	75	74	235
1921	...	...	...	72	75	80	227
1922	...	...	...	71	73	65	209
1923	...	...	...	82	68	48	198
1924	...	...	...	84	70	55	210
1925	...	...	...	83	70	58	211

¹ See Statistical Tables relating to Banks in India, 1925 Issue.

The shroffs and the rural indigenous bankers who receive deposits can be compared to the London goldsmiths who were the real forerunners of modern banks in England. These goldsmiths took care of the money deposited with them and seeing that the whole of the deposits were never called up at once began to issue notes which passed as money thus building up a machinery of credit which enlarged and extended the usefulness of the actual moneyed capital deposited with them. Such an enlightened policy the indigenous bankers have never attempted to pursue even though the early European banks pointed out the possibilities of such steps. The right of note-issuing was never exploited by the indigenous bankers even before it was annexed by the Government in the year 1861.

The Issuing and Discounting of Hundies by Shroffs or the Urban Bankers.

All banking transactions in India are exclusively in the hands of the trading classes especially in the interior of the country. Funds are exchanged from place to place by the well-known device of the hundi. Broadly speaking, hundies¹ are mere substitutes for the inland trade bills. The accommodation is secured for financing actual commercial

To complete the picture the deposits of the co-operative banks, the Post Office Savings Bank and the holdings of the Postal cash certificates should be taken into consideration.

		Year.			
		Crores of Rupees.			
		1913.	1923.	1925.	1927.
Co-operative Bank deposits	...	Nil.	...	8½	18½
Savings Bank	...	20½	...	23½	32
Cash certificates	...	...	4	...	40

¹ The word "Hundi" is a Persian word given to it by the Mahomedans. It is a generic term denoting all instruments of exchange drawn in vernacular. It literally means 'to collect.' These "hundies" generally run for an odd number of days which period was formerly 41 days at Benares, Bombay, Mirzapur and Lucknow, 61 days at Fatagar and Furrackabad, 121 days at Lahore and Multan. Some were drawn payable on the 11th and 21st day of issue. Some of them were drawn as sight bills or "darsani bills." Different sets of technical names were used for the three forms of hundies corresponding to the "vias" of the English bill of exchange. The first copy of the bill is known as "khoka," the second of the three copies of the bill of exchange is known as "paith" and the third of the bill of exchange is known as "parapaith." The method of writing out the three copies also varies and the rate of discount is known as Hundiyana and varies with the state of trade and the standing of the party.

transactions.¹ They can be safely compared to "the single name American Commercial paper"² which is freely discounted by the American Commercial bankers. Unless these hundies are freely discounted by the joint-stock banks the accommodation available for the merchants is naturally confined to limited amounts. Money is advanced by the shroffs direct to merchants or a hundi broker and dealer and in exchange the hundies are drawn and accepted by them generally repayable within 60 or 90 days. If the bazar rate is high such hundies are freely purchased and rediscounted by the shroffs at the bank rate. But if the hundi rate of the Imperial Bank is higher than the bazar rate the rediscounting of hundies does not take place.

The amount of hundies drawn depends on the state and amount of internal trade. Mr. G. F. Shirras states that the number of hundies are on the increase, but in the interior, specially at Allahabad, Benares and Cawnpore, they are becoming fewer due to the fact that there are available at present many cheaper and secure means of remitting money thus dispensing with the use of a hundi drawn for remittance purposes. Formerly when railway communications were not very much developed the bankers used to earn much money from this source. But now other means of conveyance of money notably the splitting up of paper money, *i.e.*, Government notes into two parts³ and sending each part separately, money orders, currency transfers and bank drafts are being used for remitting money from place to place.⁴

¹ Some of them are *pure finance bills* known as hand bills and the banks are careful in discounting always a limited amount of such bills for the shroffs. See Appendix to the Report of the Babington Smith Committee.

² The "Commercial paper" is used for financing domestic manufacture and trade and is issued against the credit of the concerns while the bill of exchange and bank acceptance is an "adopted child" used for financing movements of raw materials and foodstuffs in foreign trade and represents specific commodities in storage or transit. See Burgess, "The Reserve Banks and the Money Market," p. 134.

³ It has recently been suggested that the practice should be discouraged. This would tend to diminish the popularity of the high denomination notes without at the same time leading towards increased use of bank drafts or cheques.

⁴ The "Javabi" hundi remits money in this manner. The drawer goes to the indigenous banker and asks to remit money to the payee in another place whereupon the banker instructs his agents to pay money to the payee. The payee has to attend the office of the banker and give a receipt for the sum received by him. The banker can cancel his order to pay in case the drawer fails to keep his promise to the banker. This partakes more of the nature of a letter of recommendation than a regular bill of exchange.

With the opening of the branches of the Imperial Bank of India a change has come over the situation. Even the Government does not issue a currency transfer on a place where a branch of the Imperial Bank exists. They are issued on treasuries where the Imperial Bank has no branch at the same rates approved by the Bank. When postal facilities become interrupted due to strikes on railways or of postal employees, funds may be remitted by means of these transfers.¹ But an important part is played by the indigenous banker who finances to a great extent the moving and storing of crops required for local consumption and for export purposes and these loans are repaid to a considerable extent out of money obtained from banks.

The hundi² changes hands like the bill of exchange. The dishonouring of a hundi is very rare.³ The ordinary way of writing a hundi in some parts of the country is by writing transversely across the paper. It bears an impressed stamp and is drawn up in the vernacular 'mahajani' as it is usually styled.

The indigenous bankers of the earlier days usually gave drafts upon any place in the world, *viz.*, Constantinople, New York and San Francisco. These letters of credit were drawn after letters of advice were given so that they might be honoured on all occasions. Mr. R. M. Martin says that "these native bankers corresponded not only with the leading shroffs in the principal cities of India but also with their confreres in Constantinople and in the large cities of Asia. By this means European intelligence was, before the establishment of communication by steam, known among the natives in the bazar at Calcutta long before the Government received official tidings."⁴ At

¹ During May and June, 1921, when there was a strike on the Assam Bengal Railway resort was taken to this method of remitting money.

² Local usages in respect of hundies are so numerous, uncertain and undefined that the Government of India feared to abolish them and the Select Committee of 1878 expressly introduced a saving clause in the Negotiable Instruments Act recognising the full force of local usages. "Dhani" hundies pass from hand to hand like bank notes. The word "dhani" means owner, but still it is not interpreted as bearer so as to bring the matter within the penal provisions of the Paper Currency Act. In "Shajog" hundies the word "Shajog" means a respectable holder of the bazar. Acceptance is not necessary in the case of the hundi.

³ This has been the case since very early days and C. N. Cooke testifies warmly to the integrity and honesty of the indigenous bankers.

⁴ See "Indian Empire," Vol. III p. 559.

present we find the shroffs of the Presidency towns accepting hundies and honouring hundies of these up-country clients who are dealers in goods, and gold and silver bullion.

Rediscounting Trader's Bills.

The shroff acts as the middleman between the Imperial Bank and the joint-stock banks on one side and the vast trading community on the other. He buys the trader's bills, *i.e.*, the hundies at a high rate of discount for ready money and when he has not enough money to carry on this business he simply rediscounts these bills or hundies at these big joint-stock banks. The Imperial Bank considers this business safe as the shroff's endorsement makes it doubly strong, and as the shroff takes good care as to the nature of the hundies there is no danger. He can safely be considered as the bill-broker of our hundies in the money market.¹ Like the bill-broker of the London Money market he usually borrows money at very low rates in the market on "purjas," *i.e.*, demand pronotes generally repayable within a month. As the rate at which the interest is paid is $1\frac{1}{2}$ to 1% more than the deposit rate of the joint-stock banks, the shroffs act as formidable competitors to banks in this respect.

The Multani bankers of Bombay consider this discounting of hundies as their main line of business and they obtain handsome profits amounting to lakhs of rupees. Keen competition exists for this kind of business in the Bombay money market and profits arising out of the difference between the two rates of discount is necessarily small. But as in the London Money Market we do not meet with a uniform rate of discount for trade bills in our local markets.

In Bombay there are two sets of the indigenous bankers, *viz.*, the Multani bankers and the Marwari bankers. The Multani bankers conduct this discounting business, lend money and confine themselves to banking business proper while the Marwari bankers transact other business. The Multani bankers purchase the hundies drawn for two

¹ The only difference consists in the fact that the bill-brokers of the London Money Market are chiefly dependent for cash on the banks. "All that the bill-brokers' " capital consists of is " a boot and a bill case " but our indigenous bankers are more independent of banker's help.

See Appendices to the Report of the Babington Smith Committee, pp. 13-14.

or three months and they are discounted generally at 6 to 9 per cent. rate of discount. These are rediscounted at the Imperial Bank and the difference between their discount rate and the Imperial Bank rate constitutes the profit for them. The endorsement of the nature of banker is important and necessary and so the merchant trader has to pay this price. Unless a bill of exchange or hundi contains two supporters the Imperial Bank does not discount it.

There is an association of the Multani Bankers which regulates their rate of discount in accordance with changes in the Imperial Bank rate. There were about 200-250 members (in 1925) and a small Committee of five members. The most senior of these bankers generally meet and regulate their discount rate.¹ They hold their meetings on every Sunday to discuss common matters pertaining to all of them. The high degree of integrity which exists among this community is a noticeable feature and it is a pity that the Indian Joint-Stock Banks do not emulate this noble example.

The Native Bazar Rate.

No set of statistics can ever be collected which can show how readily and to what extent money flows from the European market to the important money centres of the country. J. M. Keynes says "the native market is ultimately dependent for its funds on the European market." According to him the rate in both the markets must move up and down in one and the same manner when money is required during the busy season. The difference between the two market rates is due to the kind of business transactions undertaken by them and to the nature of the security attached to this business. During the last decade of the 19th century there existed no intimate relation between the two markets.² Whether the conditions were quite abnormal as

¹ Even in Calcutta the Merchants' Committee and the Marwari Association makes provision for the settlement of disputes concerning hundies and the new regulations recently passed in connection with "hundies" payable at sight are enforced by this Association alone. See *Statesman*, Sep. 28, 1928.

² The Controller of Currency in his Annual Report makes a quotation of both rates in the Bombay and Calcutta money markets and a close study of the rates over a period of several years convinces one that there is not now-a-days a great difference between the Imperial Bank hundi rate and the Bombay bazar rate where keen competitive conditions exist. During the whole of the year 1927-28 the Imperial Bank discounted hundies at the

suggested by Keynes or whether the same facts are being repeated every year there are no official means of ascertaining.¹ There is a 'spread' between the two rates and as competition between them becomes keen, the margin would disappear. The rates would naturally reflect the nature of different risks undertaken by them. The native shroff rarely discounts foreign trade bills.² He generally confines his attention to hundies of Indian merchants and traders and as he knows full well their commercial standing he undertakes little risk in discounting the hundies. This fact must generally account for the difference or "spread" between the two rates. The Indian bank rates are influenced largely by the fact that they have to finance produce for export to foreign markets and for buying raw materials for the Indian industries. Shroffs' money finances internal movements of crops and money ultimately comes from the banks to repay these advances. The Shroff's rate is considerably easy as he gets also other's money in the shape of deposits or he borrows on "purjas" and on account of their great financial strength they can and must underquote the bank rate to find employment for their funds. In the slack season when money goes a-begging, their rate is one per cent. lower than the bank rate. This is the real cause for the "spread" between the two rates. It accounts for the high rate in the indigenous money market also. The stringency of the money market and the keen demand for money makes them seek the aid of the Imperial Bank. Such a thing cannot be allowed when the Central Bank is created to control credit. If it fails to control either the joint-stock bank's rate in the slack season or the native bazar rate there would be, really speaking, no control over the credit situation. Like the joint-stock banks, the shroffs also must look upon the Central Bank as their guide, philosopher and friend. They must work in fairly close alliance with the banks and the Central Bank of the country.

prevailing bank rate alone. If this tendency continues the old-fashioned definition of bank rate as the rate for advances on Government securities must be given up.

¹ *Vide* J. H. Sleight's letter submitted to the Fowler Committee. This letter explains briefly the nature of the shroff's work as regards rediscounting of hundies with the Presidency banks. See Keynes, "Indian Currency and Finance," p. 196.

² "They take up foreign bills also if it suits their book," says W. F. Spalding, *Eastern Exchange, Currency and Finance*.

A committee of the shroffs can be established in all the money centres so as to provide the first example of the discount market as distinct from banks. The banks and the shroffs must work in a spirit of partnership for such a thing would be to their common advantage and the banks with their larger clientele ought not to murmur at the anxiety of the shroff to borrow deposits from the public by paying a higher rate of deposit.

Other Functions than Banking (Non-credit Functions).

The private banker and the smaller moneylender generally combine business with trade and shop-keeping or hold land and do commission business and very often in order to get rich quick they speculate heavily in all kinds of produce. They do mortgaging business which often involves them in litigation. The indigenous banker specially the shroff speculates in Government Paper during the off season but very rarely holds it or lends money on it. Some of the most desperate gamblers in the market of speculation are to be found among the Native bankers of Western India.¹ Their hard business qualities are thus grossly misused and the community does not derive much benefit out of their business energy. These trader-bankers and commission agents cannot be considered as modern bankers. It is the shroff's business which consists of the bill-broking business, and in addition to it lending and borrowing on a large scale that can be reckoned as the nearest possible approximation to modern banking business and in the future reorganisation of the banking system he must be considered as the keystone of the banking arch. The complete fusion of the indigenous money market with the European money market can only be accomplished through this invaluable nexus—the shroff. His future position can be likened to that of the bill and acceptance house in the London money market. His main business would be the hall-marking of bills for purpose of currency and getting the same discounted or rediscounted at the hands of the joint-stock banks and the Central Bank of Issue. Rediscounting can indeed be a cheaper

¹ Vide Sir R. Temple, "Journal of the Institute of Bankers," 1881; see also Sir D. E. Wacha, "Bombay Municipal Government," pp. 21-22.

A beautiful description of speculation in Bombay during 1864-66 is given in these pages. See also the Sir C. Jackson Committees' Report on the failure of the Bank of Bombay in 1868.

source of financing his operations but there is no reason why he should be deprived of the privilege of attracting deposits which he is at present doing in the money market. It is stated that this is forcing him to charge higher rate for discounting hundies in the busy season when he can find work and as he is saddled with heavier deposits attracted at a high competitive rate he is forced to pass it on to the clients in the shape of high discount rates he charges during the days of employment. Joint-stock banks feel the pressure of this competition and it is suggested that it would be better to deprive the shroff of this privilege of attracting deposits and compensate him by giving greater rediscounting facilities.

At Cawnpore¹ the native bankers or the moneylenders trade in money, cotton, grain, flour and other articles. Some of them manage the sugar works and the flour mills. At Delhi the indigenous banker finances the goldsmiths and skilled workers. The banker of the East adheres to the practices of the guilds that are comparatively neglected by the great money lenders of Europe and counts jewels among his means of trade and not as objects or curios to be kept in his safe. He makes systematic advances to the goldsmiths and sells the finished product himself. He tries to efface the maker of the goods he sells and poses as the actual producer. Thus he appears to be both a jeweller and a banker. In Bombay the Marwari bankers deal with cotton, seeds and shares and do much speculation in the value of these things. The Natukottai Chetties of Burma who have developed the indigenous banking system of Burma, finance agriculture on a large scale and promote habits of thrift and economy by the insistence of prompt payment of both principal as well as interest.

In several other countries also the private bankers who do not subject themselves to any official regulations pursue an elementary form of banking business in addition to other and more lucrative forms of business. But the main defect of this kind of business is that the depositors of the private bankers stand to lose their money if the

¹ There is an indigenous bankers' Association which undertakes the duty of settling commercial disputes, regulates the discount rate and settles monetary claims. This Association is the modern counterpart of what Dr. R. Mukherjee describes as guilds. The bankers' guilds existed in the past and some specimens of these guilds might still be seen in Jaipur, Multan and Marwar—the original home of the indigenous bankers.

private banker suffers on account of his outside activities. In spite of this disadvantage attendant on private banker's mixed banking, we find that in almost all countries, country banking is admittedly of a mixed nature.

Organisation of Business.

Some of the bigger indigenous bankers have their own castemen employed as agents at all the important trade centres of the interior. These agents or "gomasthas" are oftentimes changed from centre to centre in order to enable them to understand the local conditions of these several places and when once the agent is made permanent he serves the employer the whole of his life-time and devotes the whole of his energy to the success of his firm. Although the pay given generally ranges from Rs. 30 to Rs. 60 a month, dishonesty on the part of these officials even in these present days of economic pressure and rising standard of living is of rare occurrence. These send weekly accounts of their work to their head office and occasionally receive instructions from the head office. Their books and accounts are written in the local vernaculars and they are carefully audited by the indigenous banker himself.¹ This personal supervision goes a long way in preventing fraud on the part of the officials and it also gives a close mastery of facts and figures relative to his business.

Their Public Spirit.

Every year on the "Deepavali" day the Marwari and Guzerati bankers worship their books and distribute alms to the deserving people on that particular day on a most lavish scale. The Brahmins are fed with sweetmeats and other delicious dishes and given a handsome Dakshina or present on this New Year's Day for them. The new account books are placed on the same pedestal as the goddess "Lakshmi" and worshipped. Some of the indigenous bankers set aside a small moiety of their gains in a small charity box on each and every item of profitable business. In the big

¹ The village banker who is more a lender of money than anything else keeps no accounts and the Marwari Bankers keep a memorandum book in which they keep their accounts. But there is no elaborate system of book-keeping in this case also.

cities where a number of these bankers transact business these gains are pooled and their general association¹ determines the best manner in which it is to be spent. They are well aware of the old adage which says 'charity begins at home' but are not forgetful of the saving clause that 'it does not end there.'

The Indigenous Bankers' Associations.

In all the big commercial centres of modern India where a number of these indigenous bankers transact business, they form associations to protect their mutual interests, decide financial claims and arbitrate on social disputes even. Their spirit of social co-operation, their sense of mutual economic interest and the high degree of mutual trust is so great that they submit all their commercial disputes to their arbitration courts and their decisions are virtually carried out thus resulting in great organic and functional solidarity. It has also tended "towards the development of commercial law in this country on a strictly democratic and ethical basis."²

Is it wise to deprive the Shroffs of Deposits ?

Mention of this suggestion has been made already. This suggestion does not seem to the writer quite in keeping with the practice prevailing elsewhere. Again it would be fraught with disastrous consequences and tend to encourage the hoarding habit on the part of the present depositors who entrust their savings to the shroffs.

The bill-brokers of the London Money Market attract funds by paying a slightly higher rate, viz., $\frac{1}{4}\%$ more than what the joint-stock banks pay their depositors. This fund forms the nucleus out of which

¹ Even in the matter of helping poor and deserving people one prominent member of the association heads the subscription list and passes it on to other members and each member contributes his own quota. The common realisation of their aims, their solidarity of interest, their spirit of mutual help and co-operation are all noteworthy features. The Indian joint-stock banks have no association of their own. The existence of such an association would teach them all these necessary qualities that conduce for success in their business.

² Dr. Radhakamal Mukherjee, "Democracies of the East."



he secures the needed finance for his bill-purchasing operations. He holds the bills provided he has the wherewithal to do so. He constantly borrows money at low rates from the banks to carry his stock in trade. Similarly the shroff, whose future business should solely consist of dealing, *i.e.*, buying and selling bills, should be allowed to discount bills and hundies with the help of borrowed funds in the shape of deposits. The joint-stock banks should pursue a more vigorous policy in the matter of attracting deposits and the problem of stabilising the rate of discount all throughout the year and reducing it to a lower rate than at present, can be solved by placing greater resources for discounting or rediscounting. In future when a change in the financing of domestic trade is likely to be ushered in and when increasing number of bills are to be bought, the bill-broker should himself possess great financial resources. For the present there are very few agencies who can buy the bank acceptances. Hence a bill market cannot be created so easily in his country as it has been done in the U. S. A.¹ during a short span of thirteen years.

Secondly, if he is forced to hold the bill or carry the assortment of bills on his shelves till the period of their maturity, he is apt to be more cautious in exercising his discrimination in the matter of selecting his merchant clientele whose bills he holds. Mere rediscounting, as is done by the "running" bill-broker in the London Money Market, would lower the standard of selection. Although he stands to pay heavily for any failure of the bills he has succeeded in rediscounting at the hands of the joint-stock banks, still he might prefer to run this risk, for unless there is a big turnover of bills through his hands he would not be securing as much profit as he does when he holds the bills at maturity, which he can hope to do only with greater resources he can attract in the shape of deposits. Again if bills are drawn for a longer period than three months the bill-broker must have ready finances to enable him to sit on the bill till the bill comes within the period of time for which the banks would be in a position to discount. It is not meant that the whole

¹ For the list of buyers of bills see Burgess, "The Reserve Banks and the Money Market," pp. 139-141.

of the capital and deposits should be employed in the form of discounting but a considerable part of his business might be in this direction.

An Elastic System of Rural Credit.

We have already seen how the indigenous bankers, specially the rural bankers and the smaller moneylenders, play a quadruple role. They are the purchasers of rural produce, and sometimes the local agents of the European mercantile firms, the village shopkeepers and moneylenders. Thus the more general practice is that the indigenous money lenders, who are styled bankers, as soon as they attain a decent stage of opulence and wealth, have brought the real sedate and painstaking bankers like the shroffs into great disrepute. By the concentrating of too many jobs or as the old saw says, "too many irons in the fire" such as banking, agency, commission brokerage and middleman's profits, they have failed to develop into modern bankers. Besides acting as an intermediary and accountant as the joint-stock western bankers do, the indigenous moneylenders, miscalled bankers, generally wish to take unfair advantage of their business habits, greed for gain, education, wealth and social position. The ignorant, short-sighted, extravagantly-minded and long-suffering agriculturists too often fall a prey to the crafty moneylenders. The main problem here is to reduce the high rates of interest and deprive the money lenders or the low set of usurers, their power to squeeze the improvident, wretched and helpless borrowers. Money-lending for productive purposes by initially solvent borrowers is indispensable in the economic organisation of not only *our* but *any other* society. Timely, seasonal and regular lending of financial resources at a low rate by sympathetic agents to needy agriculturists or industrialists, is essential for their mutual prosperity. It is not by merely enacting usury laws, regulating professional moneylending by registration, fixing maximum rates of interest, passing rural insolvency acts or restricting the usufructuary mortgage of land or fixed property for a definite period alone and prohibiting the alienation of land to non-agricultural moneylenders that this deplorable situation can be met. It cannot be solved by such negative measures. Only positive remedies such as the creation

of an elastic system of rural credit and the educating of the rural borrowers are essential. In succeeding chapters the creation of an elastic system of rural credit would be discussed in detail.

Educate the Rural Borrowers.

But much improvement cannot be realised in rural economic organisation so long as the new banks which should displace the usurious money-lenders grant loans for unproductive purposes to the improvident borrowers. One school of opinion wishes to exonerate the Indian agriculturists from the charge of improvidence. The advocates of this school point out that the indebtedness of the Indian peasant is generally of a cumulative character. Secondly about 50% of the money is borrowed for agricultural purposes, *i.e.*, improvement of land and purchase of live-stock. Although there is much truth in this remark¹ still the lack of foresight and knowledge makes them incur improvident expenditure and if a scrutinising enquiry were to be made into the causes of agricultural indebtedness the following would have to be taken into consideration. Wasteful social expenditure on religious ceremonies, social customs,

¹ A recent inquiry in the Kistna, West Godaveri and East Godaveri Districts, conducted by the Settlement Officer, reveals that 37% of the delta ryots and 40% of the upland area were indebted and a classification of the reasons for the incurring of debt proves that only a small part of the debt was for unproductive purposes.

Origin of the debts.		Percentage of total debts.	
		Delta.	Upland.
Purchase of new lands	...	28%	18%
Cultivation expenses	...	24 „	29 „
Liquidation of old debts	...	8 „	24 „
Marriage expenses	...	14 „	7 „
Family expenses	...	10 „	9 „
House building	...	8 „	6 „
Litigation	...	1 „	2 „
Kist	...	1 „	1 „
Trade	...	3 „	1 „
Miscellaneous	...	3 „	3 „
		100	100

These figures relate to a prosperous tract and I consider that in a more backward area the proportion of indebted people would not only be high but the proportion borrowed for unproductive purposes would also be relatively high.

seasonal feasts and caste dinners leads to lavish spending quite out of proportion to the actual income. Unaware of the utility of keeping family budgets these ignorant peasantry contract debt which they find it impossible to repay unless a sudden windfall happens. Even during days of prosperity the previously contracted debt is not extinguished in full. It is generally spent on some other function with the result that the heavy load of debt is not curtailed. Banking firms preaching thrift as in France or Germany are altogether non-existent. Successive overwhelming natural calamities drive him into the arms of the merciless money-lender. The lack of economic reserve or staying power forces him to sell the crop to middlemen who absorb a large portion of the consumer's payment. The absence of scientific farming, lack of subsidiary industries, the cultivation of uneconomic holdings, litigation, and the lure of city pleasures are sometimes the predisposing causes which lead to agricultural indebtedness.¹ Education must open the eyes of the illiterate agriculturists as to the danger arising out of wasteful social expenditure. The growth of public opinion must help him to condemn these standards of living. It is not mere provision of suitable credit facilities alone that can solve the problem. Self-confidence, individual thinking, civic consciousness and adequate leadership are essential to enable them to lead a life of success, efficiency and fullness. But this realisation depends on education and proper organisation of the agricultural industry.

The Present Position of the Indigenous Banker.

Thanks to the British rule a well-administered government has given perfect security and foreign capital is being invested freely in our country. The growth of banks in this country and the recent rise of the co-operative societies have tended to restrict his field of operation but he holds his own ground in a limited circle. The co-operative banks generally lend for productive purposes and the improvident man who has to borrow for social functions has been left to the mercy of the low set of usurers or money-lenders who are tarnishing the fair reputation of the indigenous bankers. The rate of interest has been drastically cut short and this is telling seriously on the rural

¹ See my monograph on "The Future of our Agricultural Industry," published in the *Welfare*, May, 1926 to June, 1927.

money-lenders. The former rates of interest have been cut down to 12 or 18 per cent. in most cases. The shroffs and the urban bankers are finding it difficult to obtain the little deposits that they used to attract before due to the opening of new banks or branches of the existing ones. Their reluctance to finance manufacturing concerns which are rapidly springing up must also go against them. The individual proprietary basis on which private banking has hitherto been conducted must give place to banks on joint-stock basis. What India wants is not bankers of this type but banks. Modern India requires banks whose policy should represent no interest but that of the depositor and should be directed solely to placing the banks' funds most profitably and wisely. Most of the money-lenders grant advances on short-term or long-term mortgages which cannot be considered as liquid assets. The money-lenders do not realise their responsibility to the community. The lending of capital for productive purposes is essential or else capital goes to waste. No adequate provision is taken by him to provide against an unproductive use of it.

The Defects of the Indigenous Bankers.

The indigenous bankers, rural or urban, have done very little to manufacture credit. The majority of their hundies¹ can be considered as merely a species of mercantile exchange. They have never manufactured credit by the issue of notes. They have not financed manufactures on a large scale. They have failed to develop into modern bankers.

The essence of banking business consists chiefly in issuing of credit and dealing in credit operations. The indigenous banker has done very little as regards the development of credit beyond issuing

¹ Mention should be made of the "Jokhmi Hundi" which is of the nature of the policy of insurance. This is a peculiar form of marine insurance common to native merchants. There are three parties: the drawer or the shipper of the goods, the hundiwala, i.e., the underwriter, and the consignee. After shipping the goods to the consignee the shippers draw a hundi and sell it to the insurer for cash which is the value minus the insurance premium charged. The Hundiwala sends the Hundi to the agent who on safe arrival of goods goes to the consignee for payment. In case of non-acceptance or non-payment the Hundiwala has to charge the consignor and the consignee. If the ship is lost the Hundiwala has to bear the loss. The only difference between the Jokhmi Hundi and the modern Insurance policy is this—the money is paid to be recovered later when the goods arrive safely according to the Jokhmi Hundi.

letters of credit from one place to another. Deposit holding and the issuing of notes are alike credit operations and the indigenous banker has left both these sources of credit untapped.

Finally one has to observe the list of direct and indirect services banks perform in a modern community. Some of the most direct services performed by the commercial banks are the provision of banking facilities and their extension by a net-work of branches. Modern banks are financial service stations. As a recent writer says "the Western banker is a financial focus of the community. He is in constant touch with investors and can help in selling stocks and bonds. He can advise on market securities, investments, credits and budgets and a thousand and one financial questions."¹ The shroffs and urban bankers undoubtedly understand all these but they rarely allow outsiders to benefit by their knowledge, experience and business acumen. Some of the indirect services are the providing of a sound and stable credit currency and system by enabling the financial machinery of the country to run smoothly. The indigenous banker weighed according to this standard will be found wanting. With the exception of the hundi business and the issuing of drafts on foreign centres of trade no other transaction of his benefits the community. Of course, he is the only thrifty man and the value of his example might be taken as the one other service he is giving to the community.

The indigenous banker or the shroff is not a scientific banker forbidding gross speculation and refusing to support overtrading or overinvestment. He himself violates all these functions. He fails to perform the elementary duties of a modern banker. As Dunbar has said "to be a bank now at this present day an establishment must carry on the purchase of rights to demand money in the future on securities and it must use in one form or other its own engagements for the payment of money upon demand."²

¹ *Vide* J. W. Mullaly's article on the Bankers and the Advertiser, Banker's Magazine, New York.

² In the previous edition numerous definitions from acknowledged authorities on banking were quoted just to show that even the shroff cannot be considered as a modern banker performing varied nature of facilities. See the classical works of the authorities such as H. D. MacLeod, C. A. Conant, Gilbert, H. P. Willis, W. R. Scott, H. White and Holdsworth.

The important role of the Western banker in aiding production and stimulating the capabilities of the captains of industries by his timely monetary help is not a distinguishing feature of our indigenous banker. The Western banker does not create credit out of nothing but the control of capital is concentrated at the bank and the banker by means of loans and advances in one form or other enables the persons in whom he has confidence to obtain the temporary use of other's money. The banker is under the strongest inducement to see that credit passes into the hands of those persons who are able to use it to the best advantage. Other things being equal, credit will pass into the hands of those channels from which its return will be certain. Credit finds its way to those who possess the highest credentials and offer the greatest security for the repayment of advances. The indigenous banker does not shrink from financing industries on industrial securities provided he is satisfied that the business is carried on on sound lines. But on the whole there is no facilitating of the employment of capital on his part. As Bagehot remarks "the Rothschilds are great capitalists but not bankers;" one must repeat the dictum that these indigenous bankers are great capitalists but not bankers.

Some of the shroffs are becoming unreliable and some of the Banks extending their unsecured line of credit to these unreliable shroffs have suffered most and during the course of last half-a-dozen years several of these have failed on the Western side of India. Sir D. E. Wacha, one of the nominated Governors of the Imperial Bank, has written most disparagingly of the shroffs or hundiwalas who specialise in discounting hundies. The present-day extension of unsecured credit to these people is not at all advisable under such circumstances. The only way of safeguarding the legitimate interests of the Banks is to insist on the reduction of these unsecured lines of credit to the lowest possible limit or exact collateral security. This would remedy many of the abuses. But it is impossible to prevent these shroffs acting as financial middlemen borrowing from the banks in order to lend to the needy at almost extortionate rates. Unless the Italian model of *Monts de Piete* or Banks of Charity for receiving legacies from which advances can be made on real estate or other articles of pawns at low rates of interest is imitated there can be no bridling of these shroffs' transactions and any failure of the original borrowers leads to the shroff's inability to pay back the funds to the



banks. Some of the shroffs suffer as a result of miscalculations in their ventures of speculative activity and reverses in other directions disable them to pay back their loan to the banks. This is the real reason for the large number of bankruptcies on the Western side.

"A nation gets the banking system it deserves" and it is a matter of sincere regret that in the past due to internecine warfare and political turmoil there was no free scope to the growth and development of real and legitimate banking business in India on lines which the Western countries have developed.

The efficiency of a banking system should be tested by three crucial tests, namely, stability, adaptability and initiative. By stability is meant firmness and security from all outside dangers. As the Right Hon. Reginald McKenna puts it "all precaution in banking is based on the assumption that some time or other the extraordinary may happen."¹ A banking system is perfectly secure only when a margin or provision is provided for safety in case the extraordinary were to happen. When credit is rudely shaken the banking system should possess not only inherent strength but capacity to restore public confidence. This quality is the *sine qua non* of all banking business. By adaptability is understood the power to adjust itself to new conditions and when trade and industry are making progressive strides the banking system should be able to extend its scope of business and undertake new functions to suit the changed conditions of social and industrial life. By initiative is meant the quality of creating new developments.

The indigenous banking system possesses to a remarkable degree the quality of stability. The constructive lines on which the business is conducted and the close business knowledge of the several customers and the cautious way in which loans are granted, conduce to stability and so long as the indigenous banker pursues the principles laid down by his ancestors there is no danger to him. But the indigenous banking system is woefully wanting in adaptability and initiative.

¹ His evidence before the Bradbury Committee on Municipal Savings Banks, quoted from the Report, p. 42.



Why has he failed to become a Modern Banker. ✓

While in Japan the merchant families which conducted banking business in the days of the feudal regime soon adapted themselves to the transformed economic organisation and became the heads of modern banks, no such forward and progressive movement can be noticed in this country. It is the environment that must be held responsible for this unprogressive nature of the indigenous banking system. We have seen how short-term and long-term mortgages are granted by the money-lender even for unproductive purposes. He has to respond to the call made by some of the improvident people as his self-interest gets the better hold of him than his banking knowledge. So long as people do not know the art of living and cannot arrange to spread their resources in such a way as to last over the whole of the year, recourse to the money-lender is inevitable in the days of unemployment. So long as the laws help him in the realisation of the terms of the contract, however unconscionable a bargain it might be, the indigenous banker or money-lender grants the loan. ✓ Having spent the loan for unproductive purposes there are no resources available to pay back the loan. The money-lender has to nurse the client till the loan and the interest comes up to the value of the mortgaged property. ✓ Then the unfortunate process of "land-grabbing" culminates and the money-lender becomes installed as the rightful owner of the mortgaged property. ✓ So long as these economic conditions prevail, i.e., so long as the people do not learn the art of living and so long as they have no subsidiary means of livelihood to attend to, in the slack period, dependence on the money-lender is inevitable and the law of demand and supply operates mercilessly in raising the rate of interest. Even the European banks cannot hope to work wonders in such an atmosphere as this. We have seen elsewhere the real limitations that check their utility and act as a drag on their further expansion. So the only solution is to change the economic organisation and the real meaning of rural reconstruction is nothing more than deliberate economic transition in a way conducive to the interests of all parties. Education as to the art of living, and the provision of suitable subsidiary occupations are essential before there can be any real hope of spreading genuine banking business in the rural parts of our country.

Suggestions for improving the Indigenous Banking System.

Modern economic development is so rapid that to-day's aims and methods, become antiquated very soon and the indigenous banking system which is still conducted on time-honoured and stereotyped lines has not so far displayed any signs of adaptability. It has been the cry in India ever since industries began to be organised on the joint-stock principle of management that more capital should be accumulated. Thus it becomes clear that the first duty of the indigenous banking system should have been to mobilise the money power of the country and provide the needed credit for industries to run in perfect order.

But the indigenous bankers have never devised any scientific means to stimulate thrift and encourage the saving habit on the part of the people by systematically attracting their deposits. Secondly they have not acted as the middlemen between the savers of capital and the entrepreneurs who have needed the capital. Theirs is purely a selfish and sordid motive, namely, that of interest. So long as a high rate of interest can be procured the indigenous banker will lend money for unproductive purposes even. In Western countries "banking accommodation stimulates production and increases consumption." In the case of the indigenous money-lenders the loans are sometimes granted for unproductive purposes and the result is destruction of capital and sheer economic waste. He should realise that a bank is a reservoir of liquid capital which can be directed here and there when it is needed for temporary or seasonal use and thence be returned to the reservoir for another mission. Credit is not an end but a means to an end and hence it is necessary to ensure that money is advanced for a useful purpose.

(Up till now no signs are visible that the indigenous money-lenders would invite deposits.) This they decline to do because it involves risks and a crisis may ensue if they borrow short and lend long. This is nothing but mismanagement of funds allotted to them and any locking up of funds in unrealisable assets is not sound banking. But it is high time that they should bestir themselves and do their best in promoting the new-born industrial activity spreading over the country. Unless greater capital is demanded by the agriculturists which they would not do, so long as fragmentation of uneconomic

holdings exists, no attempt would be made to gather deposits. But once a call is made the people who know these bankers intimately will be willing to entrust them with their savings. The machinery of Joint-Stock Banks as regards the deposits is cumbrous and little understood by the people. So they will certainly prefer the indigenous banker so familiar to them to the Joint-Stock Banks which have to be managed by outsiders or foreigners. In case there exists no co-operative bank in a village the next best thing is to induce the village Mahajan to take up this policy of attracting deposits and pay for them. No doubt this is irksome to him but such a progressive policy will ensure the success of many industries and obtain much reputation for him for facilitating our onward industrial march. Next to the Co-operative Banks he will be the most successful agent that can succeed in gradually weaning the people from their hoarding habit or converting their savings into ornaments.

The indigenous banker is lacking in initiative. He has not taken the lead in new lines of development nor has he opened any fresh avenues of expansion. The successful development of cottage industries, with the help of 'machinery aiding the skilled craftsmen, can be easily taken up by these monied people.¹ The village Mahajan finances the agriculturist and granted that there is a favourable monsoon and profitable employment of capital the Mahajan obtains the capital lent and during the slack season it has to lie idle in his hands as there is no demand for it. The money can be profitably utilised in encouraging local industrial talent and as the Mahajan knows fully the success or otherwise of such an attempt on his part he ought to make a sincere attempt in this direction. Such legitimate promotion of cottage industries on his part, but not sweating and exploiting as is the case now, would not only earn him a fair return of interest on his capital all round the year but it will enable the struggling agriculturists in many instances to eke out their own livelihood and increase their famine-resisting capacity.

The shroffs have never attempted to standardise the form of the hundies. There is a bewildering variety of usages as to their form

¹ The Mahajan must try to make them capitalist producers but not his own serfs, as it has been the case, in agriculture. He should have an interest in the economic welfare of his clients.

execution, endorsement, negotiation, discounting and payment.¹ A unification of these different systems would be of much benefit to inland trade. This is the task that should be undertaken by the indigenous banking associations. Although the bulk of the hundies is of the usual English style that is used in the foreign trade of India, still a complete uniformity is necessary in the case of these bills used for inland trade.

Neither the indigenous bankers, the shroffs nor the village bankers or money-lenders, have realised the higher duty of a bank. The primary duty of it is to earn dividends for the share-holders. The next higher duty is to help the trade and industry of the country, to stabilise the financial machinery and provide stable credit for the millions of its inhabitants. The indigenous bankers are not fired with the necessary zeal and enthusiasm to realise this high ideal. They are careful of their own materialistic aims and pursuits. Many of them are hidebound by caste or conservatism. They lack the driving power. They have prudence, business judgment and sense of relative proportion. They need aggressive constructiveness, enthusiasm and above all imagination and without these there would be no progress. They must educate the borrowers in banking principles and the need of strict punctuality in paying off their liabilities. Whatever future developments may be effected in the reorganisation of Indian Banking, these indigenous bankers must be used as the chief back-bone of the banking system. The shroffs must become an integral feature of the open money-market that would have to be created in the near future. The indigenous Joint-Stock Banks should freely rediscount the hundies and internal trade bills so that the financial difficulties of the merchants would be removed to a great extent. The Central Bank should extend greater facilities to the Joint-Stock Banks by freely rediscounting these bills. The creation of an open discount market and organised money market will tend to lower and stabilise money rates and confer the much-needed stability to the resources of the Commercial Banks.

While the shroffs and the urban bankers can easily adapt themselves to changing circumstances with a little initiative on their own

¹ An idea of the different variations in the local usages in the matter of hundies can be obtained by consulting the "Indian Negotiable Instruments Act" by K. Bhashyam and Adiga (1917 Edition).



part, the task of reforming the rural money-lenders or banker's business is no easy one. Bankers are the creatures of their environment just like other human beings. Unless an all-round improvement is brought about the money-lender cannot play a more useful part in our society and the evils of usurious money-lending would still persist. But they must be made to start banks or aid the opening of branches of the existing banks. They must play a more important part in commercial and industrial expansion of the country than at present. For a long time to come it would be inevitable on their part to lend for long periods as there is a shortage of capital for long-term investment—a shortage which the European Commercial Banks cannot completely remedy. An intimate relationship ought to exist between these bankers or money-lenders and industry. These monied families must take the initiative in commercial and industrial development. Taking Japan into consideration we find the great Mitsui family owning banks, shipping lines, mines and factories. "A great part of the foreign trade passes through its hands. It is not only an importer of raw cotton on a great scale but it even controls cotton plantations in the United States. It forms one of the most important firms engaged in the silk export trade and in the development of the resources of the Japanese Colonies and China." The Mitsuibishi firm affords another laudable example. It controls banks, insurance companies, and trading concerns which engage in iron and steel production, in mining, shipbuilding, aircraft manufacture and electrical engineering. The State has from time to time turned over the control and ownership of factories or shipyards, which it initiated, to these great firms and it has aided them by granting subsidies and privileges of various kinds. It is largely through these semi-official firms that the Government is able to keep its hand on the reins of Japanese economic enterprises while they in turn are strong enough to exercise a considerable influence on official policy."¹

Whatever might be their present-day shortcomings it must not be denied that they are rendering signal service to agriculture and internal trade. It behoves them to set aright and adjust their system to the new and altered economic condition of our life. They should realise the higher aims and loftier ideals of a banking system

¹ See G. C. Allen, "Modern Japan and its Problems," p. 135.

Asa Japan - Japan from within

and act up to them so that they may deserve fully the appellation of bankers which is now applied rather indiscriminately to all the big capitalists and money-lenders of our country.

Other Quasi-banking Institutions.

The indigenous class of institutions, *viz.*, the "Kutte-chitte" and the "nidhis" of the Madras have been performing money-lending business from a long time. In the "Kutte-chitte" system a number of men unite to put some specified sums in some specified time and the whole sum is drawn in a lot and the winning lot takes the whole sum. Next month a similar lot is drawn and the previous winner is excluded. Thus this process is continued till all the subscribers have received their lots once. The sum is repaid in easily payable monthly instalments. The law relating to the Chit Funds needs revision so as to prevent cheating and swindling by subscribers and by the conductors of these Funds. The Government of the native state of Travancore did well in embodying the legislation with reference to these provident funds, benefit funds, and chit funds in a clear and concise form. Any number of the chit funds are in operation even now in Travancore, Cochin, British Malabar, Tinnevely and other districts of South India.¹

The nidhis originated in or about the year 1850. The etymological meaning of the word "nidhi" is treasure. These are associations for mutual credit. The main object with which they were started was to facilitate savings, relieve members from old debts and grant loans for all purposes on good security. Outsiders were also given loans at a higher rate of interest. Generally there are two kinds of "nidhis," the permanent and temporary.² Although these societies were started at about the same time as the co-operative societies in Germany they have had no such brilliant career as the latter. This is partly due to the fact that frauds were committed at the early stages of their existence and want of supervision must have had its effect. The method of monthly instalments and the paying of them in clock-like regularity requires some education and

¹ See the "Second part of the Law of the Chitties" by A. M. Mathews, 1927.

² *Vide* Statistical Tables relating to Banks in India, 1919 publication, pp. 2 and 3.

thrift on the part of the shareholders and the nidhi system consequently proved unsuitable to the agricultural population. In spite of these defects these nidhis are still flourishing, says the banking blue-book, but no statistics of their number, capital and shareholders have been collected.

Sir Frederick Nicholson, who made a special study of the agricultural problem of Madras in the last decade of the 19th century, comments on the good features of the nidhi system thus. They are the introduction of co-operative principles and habits, the stimulation of thrift and providence, the inculcation of business habits and punctuality, the cheapening of credit, the insuring so long as rules are observed that the members will, if non-borrowers, get back their money with interest and if borrowers they are secured from all annoyance so long as they pay their dues punctually. Business is extended by cheapening loans and not by entrapping the unwary and ignorant. Profits are to be sought by the development of cheap credit and not by squeezing the individual debtor—small savings are cared for and petty capital retained in the neighbourhood.¹

Their Future.

It is apparent then that the "nidhi" is a good institution for encouraging thrift and so long as they are managed well they work well, but owing to growth or indifference the management may fall into bad hands. The system has been perfected more or less and is not capable of any further extension. Besides they are mere money-lending societies lacking the fundamental conception of a banking institution. There is no concentration of idle hoards for productive purposes as Sir Frederic Nicholson puts it. The co-operative credit societies fulfil these duties more admirably and there should be an extension of these institutions. The nidhis have already fallen to the back-ground.

¹ Sir F. Nicholson, "Report on Agricultural Banks," Madras Loan Societies.

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CHAPTER IX

THE INDUSTRIAL BANKS.

Need for industrial finance—The inability of commercial banks—Specialisation elsewhere—The need for specialisation—The present situation in India—The existing banks and industries—Industrial Banks for large-scale and factory-type industries—Co-operative credit for cottage industries—State aid to industries—The existing Industrial Banks—Genuine Industrial Banks needed—Certain precautions—Other suggestions—Government's move in this direction—A note on the German Industrial Bank.

Need for Finance.

That industries need finance is a self-evident proposition. Either to increase production or to buy more raw materials or to extend the site of the factory or to increase the wages of the labourers, capital is needed.¹ The entrepreneur needs capital on the strength of the industrial securities he possesses which are generally as follows: (1) the land on which the factory is constructed if it is the property of the industrial concern, (2) the factory building in which the business of manufacturing is carried on, (3) the implements, tools and machinery which are required for aiding the manual labourers in the process of manufacturing, (4) the portion of circulating capital which is set aside for the payment of wages of labourers and the clerical staff of the factory and some contingency funds laid down for future use and (5) the raw materials that have been purchased with the view of being turned into finished products. There are the properties at the disposal of the entrepreneurs and on the strength of these securities capital should be obtained for any of the above-mentioned needs.

The Inability of Commercial Banks.

But the ordinary banks or 'commercial banks' as they are styled are not in a position to grant accommodation for the following

¹ See Prof. D. H. Robertson, "The Control of Industry," Ch. V, for a further discussion of the subject.

reasons. Firstly a commercial banker is not an expert in the matter of land and building valuation. The value of land might deteriorate on account of social conditions and it might land him into a course of protracted litigation if the rights were not to be securely guarded and the ordinary banker does not care to scrutinise all these carefully and grant the needed accommodation. In fact neither has he the inclination nor the time required to value carefully these securities. Again buildings and machinery would fall in value if the company were to cease production for a time. The machinery unless looked after will be valued as old iron and nothing more. The raw materials of the entrepreneurs might be of a nature, whose value the banker might not easily estimate and so it is not possible for the entrepreneur to persuade the commercial banker to give the needed accommodation. The possibility of a labour strike, the perishable nature of the articles mentioned and the possibility of foreign competition will have to be considered. As the entrepreneur is not in a position to satisfy the commercial banker as to the nature of securities he has to offer, the commercial banker refuses to grant the exact amount of capital which the industrial securities warrant the entrepreneur to demand. The securities that satisfy the dictates of prudent commercial banking should possess the following features.

✓ As George Rae says, "they should be well-known and of a definite nature. They should be readily convertible into cash. The pledger's title should be unquestionable. They should be legally pledged to the bank. They should secure a specific debt. They should be accurately described. They should be of sufficient value to cover the indebtedness, possibly expenses of collection and contingent charges. They should be definitely located. The pledgers' character should be prudent and industrious. The securities should be of such a nature as to possess stable value. A perfect banking security should combine ultimate safety, a certainty of payment on a specified and not a distant day, a capability of being converted into money in cases of unexpected emergency and a freedom from liability of depreciation.¹ The industrial securities do not possess these characteristics. Besides this reason the commercial banker thinks that the investment of short-dated deposits in non-convertible securities is hardly

¹ Vide George Rae, "Country Banker."

consonant with the sound canons of commercial banking. Any bank that dares to undertake the three lines of financing agriculture, industry and commerce in its hand is sure to come to grief.¹

Specialisation.

On the European continent the state filled up the gap between commercial banks and industrial companies by starting discount houses for temporary periods and when this necessity was no longer felt, they were withdrawn. But now special banking institutions exist for these three purposes. In France the Credit Agricole takes up agricultural finance in its hands. The Credit Foncier takes up the business of the mortgage loans and loans to communes and thus provides long-term credit. The Durand Rural Banks based on the Raiffeisin Co-operative principles are doing good service to agriculture. The Banque de' Paris et Des Pays-Bas takes up the financing of such industries as railway building, harbours, tramways, electrical enterprises and frequently acts as the manager of syndicates for promoting industrial concerns. The Banque Nationale Francaise de Commerce Extérieur mainly exists for assisting French exporters. It has numerous agencies in foreign countries. It maintains an efficient intelligence service. It helps the French people in recovering their debts.

In Germany the Raiffeisin Co-operative Credit Societies and the Landschaften take up the business of agricultural finance. The small producer and the artisan is looked after by the Schulze Delitzsch type of Co-operative societies. The Preussische Prandbrief Bank and Preussische Central Bodencredit look after the mortgage business. In addition to these the Grossbanken play an important part in the financing of industries.² The German Banks secured financial supremacy in foreign countries while locking up very little capital of their

¹ Some of the bank failures in the province of the Punjab are an evidence of the glaring violation of this acknowledged principle.

² The German grossbanken perform the following banking operations : (a) attracting deposits, (b) giving loans, (c) discounting bills, (d) capitalising industries, (e) floating new industrial companies, (f) regulating the value of the shares by buying and selling, (g) buying and selling securities largely on their own account. All banks are members on the Stock Exchange. As Dr. Reisser explains, " these were forced to take up all these

own. They secured English and French money for the development of their own industries. The electrification of the Anglo-Argentine and the Buenos Ayres City Tramways by the A. E. G. Co., of Berlin were rendered possible by the German Banks securing loans from English banks on the strength of their own investments. Similarly the Russian Commercial Banks played a great role in industrialising Russia.¹

In Japan the Yokohama Specie Bank has been established to look after the business of foreign exchange and attend to other commercial purposes. The Hypothec Bank of Japan modelled on the Credit Foncier looks after the agricultural interests. The Industrial Bank of Japan is based on the model of the Credit Mobilier and is a financial organ for helping industries. It does commercial financing business also but only to a limited extent. It undertakes to attract long-term deposits but relies to a large extent on its power to float debentures to almost ten times its paid-up capital. Foreigners were allowed to subscribe to its share capital and it played an important part in introducing foreign capital into Japan.² It also helps the Japanese investors to invest their capital in China. The Japanese Government encourages this policy by guaranteeing its profits on foreign investments within a limit of 100 million yen.³ Besides

ultra-commercial operations in order to meet the real demand of German economic development." Although they adopted a helpful attitude towards German industries, they were managed very well from the beginning and owing to sound precautions they undertook, the credit system was not put to a severe strain. They had a high paid-up capital of their own and attracted long-term deposits. They always combined to help the financing of large industries. The Deutsche Bank acquired interests in the smaller banks and thoroughly controlled their policy. The policy of the German Banks interlocking themselves with industrial companies led to their mutual development. As Leopold Joseph says, the German people have full confidence in the administration of banks and in the integrity of the Boards of Directors which are mostly composed of capable men. Stringent regulations are in force and it is only a serious catastrophe that can shake their confidence. Many of the big banks have a large staff of industrial experts to guide their banking officials in their attitude towards industrial business. If our banks wish to imitate their tactics it is absolutely essential that they should employ the same precautionary measures as the German Banks.

¹ See Dr. H. Hauser, "Germany's Commercial Grip on the World." See also *Les banques de Commerce russes*—E. Epstein. 1st three chapters.

² During the first 11 years of its working it borrowed about £35 m. to finance Japanese State enterprise, i.e., building railways in Manchuria.

³ See G. C. Allen, "Modern Japan and its Problems," 1928, p. 166.

this Industrial Bank there are two other important industrial banks. The Chosen Industrial Bank arose in 1918 out of the amalgamation of the local official banks, and the Oriental Development Company was started in 1908 to finance enterprise in Manchuria and Korea. All the Colonial Banks receive financial assistance from the Government and from the Bank of Japan.

In England the British Trade Corporation was specially designed to grant larger and larger credits than the existing banks for the helping of the British producers. But as Walter Leaf points out "after several years of experience it can hardly be claimed that the operations of the Corporation have been so successful as to show that there was a real need for it."¹ The financial trusts and the underwriters specialise in this task. Thus everywhere there is a line of distinction drawn between the financing of agriculture, industry and commerce.

The Need for Specialisation.

It is a well-known fact that the nature of capital varies in the three lines. "In commerce money invested is brought back immediately by the disposal of the merchandise and so a long credit is not needed. In industry the capital becomes fixed in raw materials and is restored as soon as the raw materials are manufactured and sold. The capital invested on agriculture returns slowly by annual instalments. Regarding the certainty of redemption the capital invested in commerce is influenced only by artificial market fluctuations while agricultural pursuits are affected by natural causes uncontrollable by human energies, so that, to this extent, the return of capital in agriculture is uncertain. As regards the renewal of capital agricultural pursuits these unlike the other two lines, require little, the period for which the capital becomes fixed being long unless the land purchased meets with some catastrophe. In industry an early renewal is necessary to a certain extent owing to wear and tear of plant and buildings and to the sale of the articles of manufacture. In commerce the term of fixed capital is shortest; renewal being necessitated on the sale of the goods."² Thus the operations of capital are bound to vary

¹ Walter Leaf, "Banking," p. 163.

² Quoted from the N. M. Commission—Volume on Japanese Banking.



in the three pursuits and so there should be three kinds of institutions providing the necessary capital.

The Present Situation in India.

India is a slow starter. She has now started in right earnest on the long road leading to industrial development and attempts are being made to introduce systematically modern forms of Western industrialism. To help her on the long and costly journey capital is needed. By adopting a policy of discriminating protection the Government have not only indicated 'a change of heart' but have proved that they are bent on placing India's industrial equipment on a par with that of the rest of the world. Strained political feelings are leading to a combined campaign of boycott of foreign goods and the encouragement of the 'Swadeshi' goods. It is keenly felt that India must employ its own capital under Indian management or else foreign capital should be handled by Indians under their own management. It is also an accepted fact that India need not necessarily copy the Western Industrial organisation in a wholesale manner, thus intensifying the existing evils of intensive industrialism and competitive civilisation such as over-crowding in cities and the slum areas round factories. Traditional and unique manufactures requiring the specialised skill of the craftsman can be carried on and the transition to factory production need not be attempted in every industry. Machine production need not supersede hand labour in all industries. The present economic structure of India presents many interesting examples of different forms of industrial organisation. Small-scale organisation of the cottage industries with proper facilities for the training of the artisans, for the obtaining of the latest information as regards improvement in industrial arts for the provision of capital and adoption of business-like methods is no less important than the adoption of the factory system of large-scale production. The introduction of electricity or hydro-electric power as a source of motive power to aid small units in industry, thus enabling the craftsman to compete with machine products requires capital. To accomplish any of these objects more capital is needed. As soon as the Provincial Governments complete their surveys of

cottage industries ¹ as suggested by the Indian Economic Enquiry Committee, the necessity arises for adequate finance and it has to be taken up by industrial banks or co-operative financing organisations. The development of the existing moribund and decadent small-scale industries by using machine power and modern appliances is another important work. The scope for starting new industries to utilise existing raw materials in the provinces must be examined and with such an accurate preliminary survey before them the industrial banks can hope to do something in remedying the present lack of finance which is one important cause for the slackness of industrial activity. Close co-operation of the industrial banks with the Co-operative Sale Societies for disposing off the finished products would also contribute much towards the success of the industries.

| Recent experience in connection with the flotation of government loans and of company promotion has proved decidedly that capital would be forthcoming in India if only the needed facilities for mobilising capital are furnished. It is not only ordinary banks conducting commercial financing that are needed but industrial banks are necessary to help the current enterprises of every country and help the starting of new industrial concerns by underwriting their shares. Industry is now forced to pay too much for the use of money and unless this price of money is reduced and industrial credit is organised the future of industry would be uncertain.

The Existing Banks and Industries.

The Imperial Bank is prohibited to do this business by its bank charter. The other joint-stock banks slavishly model themselves on these lines, hence the financing of industries is in a backward condition. The existing Indian joint-stock banks cannot hope to lock up their money in long-term loans to industries. After the banking crisis of 1913-15 deposits generally are made for short terms, *i.e.*, six to twelve months. They charge unusually high rates even for short-dated loans to industrial concerns. They take a very wide margin in their favour, *i.e.*, 20 to 25 per cent., and this is a great handicap to industrialists. So Indian-managed industrial banks for

¹ See the Indian Economic Enquiry Committee Report, Vol. I, p. 27.

the purpose of industrial financing should be started. They should rely on their capital, long-term deposits attracted for 3 to 5 years and debentures which they can float, terminable at the end of 15 or 20 years up to ten times the volume of their capital.

No doubt the Co-operative Credit Societies are doing something to alleviate the hard lot of the small producer and the artisan. But the middle-men sellers of the articles are strong and the Co-operative Credit Societies alone are not the sole remedy. Sometimes the village mahajan finances them but his rate of interest is prohibitive. He does not possess the patience and disinterestedness which are absolutely necessary in the matter of financing industries. His predatory profit-seeking instincts make him a hard task-master. It tends to make him study and anticipate the price fluctuations and a great deal of his skill is spent in this direction instead of being utilised towards the improvement of the organisation and technique of the industry. He generally finances the cottage industries on the advance system by which funds are given in the shape of raw material or cash, and this loan has to be repaid by the sale of manufactured goods at specially low rates. The rate of interest generally works out at twenty five to fifty per cent., and the practical result is that the handicraftsmen and artisans are little better than slaves. In the past some of the artisans were not allowed even to change their employers as a civil suit and arrest were held over them in *terrorem*.¹ In almost all cases the cupidity of these financiers conflicts with the economic welfare of the industrialists and the relatively weak economic position of the latter places them at a position of disadvantage.

The foreign capitalists wish to have all the loaves and the fishes to themselves. Some of the industries have been attracting short-term deposits² and locking up these proceeds in their own

¹ See the evidence of A. E. English—Registrar of Co-operative Societies, Burma, before the Indian Industrial Commission. See also H. Rose's Description of the financing of the Cottage Industries in the Punjab. The Census of India, 1901, Vol. XVII, Part I, pp. 368-369. See also the "Survey of the Cottage Industries of Bengal" published by the Government of Bengal in 1924.

² Vide Sir Basil Blackett's speech on opening the Calcutta Branch of the Central Bank of India, July 24, 1924. It must however be remembered that the practice is not so universally adopted as it is supposed to be.

business, thus making it a "frozen asset." The depositor has no readily realisable instrument by means of which he can convert it into ready capital. The usually accepted and principal method by means of which this difficulty can be bridged is by floating debentures by the industrial companies. Some of the foreign insurance companies might safely subscribe to these debentures, thus providing industrial finance at a cheap rate and the industrialist need not apprehend a forced sale of his stock in order to pay back the sum in case of the depositors' call. Another method, which industrial companies generally resorted to, was borrowing from rich individual lenders at a high rate of interest. But underwriting has not become very popular. One of the advantages of the oft-quoted and much-abused managing system is the securing of adequate finance for the industrial companies. These primitive and inefficient methods of industrial financing must be gradually superseded. If national development is to be on a really encouraging scale, the unscientific methods of industrial financing should be remedied as early as possible by the starting of industrial banks.

Industrial Banks are the eventual organisations by means of which industrial finance would necessarily be available for large-scale and small-scale organised factory-type industries. But in the meantime the Provincial Governments would have to grant financial aid to deserving industries on the strength of the Directors of Industries' recommendation either by securing a loan from the commercial banks by itself acting as the guarantor for the borrowing industrialist or grant adequate loans as in the case of the Agriculturists' Loans Act. Other concessions as temporary exemption from taxation in the case of new undertakings in the initial stages, exemption from rent and royalties or lease of land on favourable terms would also be of material help to the industrial concern. The newly formed Advisory Board of Directors in the Provinces can give good advice to the Directors in the matter of Government help to industries. Wider extension of technical and commercial education would be another form of desirable indirect State assistance to industries. Preference in public contracts to Indian-made products can be granted provided the quality of the product is in no way inferior to the foreign one. Above all a reversal of Government policy before the industry can stand up on its own legs has to



be given up. Private enterprise must not only be assured of steady aid and development on the part of the State but no reversal of policy or State-aided competition should be initiated as in the case of the Indian wagon industry,¹ and the coal industry.

So far as the cottage industries are concerned, it is universally acknowledged that the extension of the co-operative credit system would be the best financial solution. Where this cannot be secured immediately the granting of small loans has been recommended by the Indian Industrial Commission. The task of pioneering big industries must be taken up and if this is not possible subsidies should be granted to individual pioneers in this direction. Even in a strong individualist country like Great Britain special steps were taken to develop the key industries such as the dyestuff manufacturing industry, the flax industry and the cotton industry.

State-aid to Industries.

There are some writers who consider it essential that the credit of the State should be enrolled for our schemes of long-term industrial finance. The examples of other countries granting special privileges, concessions and subsidies to national key industries can be quoted in abundance. The Spanish Royal Decree of 30th April, 1924, outlines the scheme for granting State assistance to industries.² Shipping is subsidised by most foreign governments and the Geneva resolution which condemns flag discrimination is not carried into execution by many of the States. Although there is plenty of money for industrial financing in Switzerland, subsidies are granted to the watch-making industry and these form a heavy charge³ on the finances of the Federal State. In Hungary and Czecho-Slovakia the credit situation is eased to a certain extent by the banks financing themselves from loans made by British and American Banks. In Jugo-Slavia a State Bank is contemplated to help the small tradesmen and handicraft industrialists. Loans are granted by the National

¹ See Sir R. N. Mukherjee's, Address to the Shareholders of the Indian Wagon Industry, quoted by the Capital "Indian Industries and Trade Supplement," Dec., 13, 1928.

² See the Balfour Report on the Overseas Markets, p. 92.

³ See Sir Alfred Mond, "Industry and Politics," p. 105 *et seq.* Quoted from the Swiss Government Report, June 13, 1925.

Bank in Bulgaria to the different industrial enterprises. Japan still subsidises her largest navigation companies. Thus all modern states tend to stimulate industrial development by the granting of subsidies, by the imposition of protective tariffs or by loans from official banking institutions. Already some of the Provincial Governments in India are granting loans to industries doing business in their provinces. But greater developments in this direction are essential to solve the middle class unemployment problem indirectly by allowing industries to absorb them.

The Existing Industrial Banks.

The first bank to undertake this new type of banking business on a large scale was the Tata Industrial Bank. Modelled on it several other banks have been lately started and they profess industrial financing as their avowed object. Some of the following Joint-Stock Banks have been started for conducting industrial financing:—

Name of the Bank.	When registered.	Paid-up Capital
		Rs.
The Tata Industrial Bank	11-2-1917	2,25,15,660
The Industrial Bank of Western India	1-10-1919	39,97,000
The Karnani Industrial Bank	1921	60,00,000
The Indian Industrial Bank	1920	3,26,000
The Raikut Industrial Bank	1922	2,47,000
The Simla Banking and Industrial Company...	1921	3,39,000
The Luxmi Industrial Bank	1923	1,01,000
NATIVE STATES.		
The Mysore Industrial Bank	24-6-1920	6,07,000
The Gundulpet Industrial Bank	24-7-1920	...
The Central Travancore Industrial Bank	13-9-1919	...
The South Malabar Industrial Bank	6-4-1920	...

Many of the industrial banks and several of the loan companies are attempting to imitate the Grossbanken in conducting mixed banking business. But they are totally lacking in the

forceful initiative, untiring perseverance, breadth of knowledge and organising ability which are the marked characteristics of the German banks, nor have they the requisite capital, scientific and general economic knowledge and experience at their back. They are little better than mere machineries for raising capital and much cannot be expected by their unco-ordinated action. Industries cannot be successfully worked as small independent units. Hearty co-operation should exist between the industrial, financial and commercial communities. As Sir T. Holland says, "industries cannot flourish singly but in family groups, provinces do not develop singly but in federal associations. For the essential communications, for necessary raw-materials, for markets and for financial aids and even for unskilled labour one province must rely on the resources of another."¹ This fact is more clearly emphasized by the Bombay Advisory Committee to the Indian Industrial Commission which says, "the establishment of a Central Industrial Bank or similar organisation with a large capital and numerous branches designed to afford financial support to industries for longer periods and on less restricted security that is within the power of practice of the existing banks is urgently needed as in the case of Japan a certain amount of government aid and government control are also necessary for its safe working."

** Genuine Industrial Banks Needed.*

More industrial banks which are in touch with the small industrialists and which are fairly able to estimate well the prospect of a large range of factory-type industries and which possess sufficient money which can be locked up for a long time, are an important desideratum for promoting the new-born industrial activity of the country. The industrial banks should possess a large amount of paid-up capital and attract deposits payable after a number of years. If additional capital is required it should be raised by means of debentures which may be repaid after a period of 15 or 20 years. The amount of capital that can be raised by this means can be locked up with impunity. The industrial banks should have nothing to do with short-term deposits, remittance of money and the other ordinary

¹ See the Journal of Indian Industries and Labour, Feb., 1921.

commercial banking business. The Indian Industrial Commission recommended that these industrial banks should take up ordinary banking business. This is no doubt due to the desire to make the concerns profit-making ones and whether such a thing should continue in the future will mainly depend on the number of industries forthcoming for help. If demand for industrial finance is keen it would be unwise for these banks to conduct a mixed banking business. Thereby they would be defeating the very object and intention with which they have been started. Just as co-operative credit societies are to be granted access to the central reservoir of credit under the hands of the Central Banker so also the different industrial banks can also seek to expand their credit resources by securing accommodation on their own assets from the Central Banker.

For the starting of the bigger factory-type new key industries the State must aid private initiative which puts down the requisite funds. It is by this means that India can be made independent of outside sources in the supply of these products. The State can pioneer such industries and hand them over to private enterprise after it has proved its commercial possibilities. The development of electrical power and distribution of this energy to cottage industries, municipalities, factories, mills, printing presses, workshops, etc., can be done easily in different provinces of this vast continent. The development of the electro-chemical industries is another advantage. The manufacture of heavy chemicals on a profitable scale and the development of the aniline dye industry in the country can never be accomplished without state pioneering on a large scale. The Development departments must pioneer the key industries and their work is not finished if they keep up an establishment for granting technical advice on industrial matters.¹ The Native States pursue a more benevolent policy encouraging deserving cottage or factory-type industries. An Industrial Trust Fund of one crore of rupees has been inaugurated in Hyderabad. Even the State Railway is forced to assist new industries by favourable railway rates. The State pioneering of the bone-crushing and soap industry, granting

¹ The other items of successful work on the part of the Industries Departments of the different Provincial Governments are carefully outlined by A. G. Clow, "The State and Industry," Chs. VII, VIII, IX, X, XI, XII, XIII and XIV.

of loans to industries, subscribing of share capital to the cement and glass industry and the lending of experts to solve technical problems of the cotton hand loom industry are too well-known to need any detailed repetition here.

So far as the existing factory-type industries are concerned the Managing agents look after the financing side of the transaction and they have wisely built up reserves in most cases so that existing industries finance themselves or pursue the policy of attracting deposits from indigenous bankers and lock them up to a certain extent in their own business.

Certain Precautions.

Barring the few industrial provinces like Bengal, Bombay, Bihar and Orissa and Assam, there is not much scope for these genuine industrial banks in other areas of the country. The Tata Industrial Bank did not find enough scope for this business and the maximum industrial financing conducted by it amounted to roughly 32 lakhs. The risk of prematurity¹ would have to be run if too many industrial banks are to be started. In the United Provinces Mr. C. Y. Chintamani, Minister in charge of Industries appointed a Committee to enquire into the problem of industrial financing and its report was to the effect, that no such industrial banks were necessary. No industrial banks would be needed if industrial companies accumulate handsome reserves, make provision for the depreciation of machinery and other items of fixed capital. Their short-term requirements can easily be met by commercial banks. Commercial banks can aid industries by means of their six-months loans on the security of promissory notes of two directors who will be jointly and severally liable for the debt. The problem in India, however, is different. Industrial banks have to act as partners in newly created industries and make these ventures successful concerns. Like

¹ In the economic world there is such a thing as equilibrium and balance and if industrial banking becomes very prominent as a form of business activity and if groups of industries do not also arise, it becomes relatively unprofitable and remains so till other groups of industries have caught it up.

the German Banks which acting in co-operation with shipping, insurance and railway companies, looked after the sale of the finished product and secured foreign markets for it, the genuine Indian industrial banks would have to pursue a similar programme of *initiating, developing and expanding* the factory-type industries of our country.

*The Principles of Industrial Credit.**

The industrial bank should not finance solely one single interest or a single group of interdependent interests because the bank's fate will be ruined in case any calamity befalls that industry. The way to help new industries is to supply initial capital after carefully examining the business proposals or provide a money loan after the industrial concern is floated in the market. It can grant loans on the industrial securities of the concerns or it can underwrite some of the company's shares itself. But it is essential in this case that the Directors of the Bank should first of all know something of the undertaking. It would be wise if it were to employ specialists in this direction to examine the proposal and pronounce their opinion on the future prospects of the industrial undertaking and be guided according to their advice. The advice of the Industries Department can also be enrolled for the same purpose. The Industrial Bank should wisely distribute its capital, *i.e.*, loans on plant, buildings and lands should be well-considered and limited in each case but it is always in its interests not to invest a large proportion of its resources in providing working capital to new concerns. The success or otherwise of the bank would depend on the limitation of each class of business to its proper proportions. But, of course, when it supplies much initial capital it should take care to protect its own interests by employing one or two of its men as directors of the new industrial concerns. Its role should be that of a confidential adviser.

The task of rendering financial help to all industrial concerns lies before the industrial banks that have arisen and that are yet to arise. The Federation of the Bengal Loan Societies should not only act as the financial provider to the 600 Loan companies that would be affiliated to it. But it should be able to give expert advice and encourage qualified Indians to take up the manufacturing lines where there are possibilities of success. The Federation of the Bengal

Banks ought to consider it as its duty to bring about through the Loan companies, the development of inland transport facilities by starting and financing small light railways, modernised ferry services and the motor services. The industrialisation of agriculture, the starting of engineering workshops and the tacking on of subsidiary industries to agricultural occupation as poultry farming, bee-keeping, dairy-farming and cocoon-rearing cannot be accomplished without long-term financial aid from industrial banks and a proper financial supervision would also enable them to meet with success. Jute mills in the different Bengal districts are essential if the emancipation of the agriculturists from the thralldom of the foreign capitalists who control the market is to be removed. An enterprising industrial Bank or the proposed Federation of the Bengal Loan companies can hope to control all existing insurance companies of all kinds—Fire, Life, Marine and Accident included on similar lines as the Calcutta American Foreign Insurance Association. Some of the industrial banks might even hope to control the sale of the exports in the foreign markets by providing suitable arrangements with foreign trade associations. The exploration of foreign markets can also be accomplished by Indian Consular agents¹ established in the foreign countries.

In Great Britain the British Trade Corporation undertook to organise study and research into new ideas and inventions and examine and nurse new schemes of development until sufficiently proved and ripe for public investment. The Corporation was meant to act as a “link between the British investor and British industry.”² Our industrial banks should have this lofty ideal before them rather than be mindful of their own interest and attend to ordinary banking business also. There is no use of merely granting loans on approved securities to

¹ Consular agents and Trade Commissioners must explore the Foreign market and communicate to the Indian Industrialists the exact requirements of consumers and acting as the representatives of the Government of India they can expand the export trade of the country. It is not the cotton industrialists or manufacturers alone that can be benefited. A museum of Indian products ought to be attached to these offices and information regarding the exhibits should be made freely available to foreign consumers. Every trade must have an export selling organisation acting in touch with the industrial banks and seek the sale of products which are not absorbed in the home market.

² For the actual work accomplished by the Trade Indemnity Co., an offshoot of the Br. Trade Corporation, see Robinson's “Foreign Credit Facilities in the United Kingdom.”

the existing industries. In the absence of trust or finance companies or under-writers, they must float undoubted industrial companies underwriting their capital and offering the public ample facilities to invest their humble savings in these new undertakings so that they should not only be helping the existing industries but actually create new industries where there are possibilities of success. If Indians possessing the necessary industrial initiative and resourcefulness are not to be had, they should persuade enterprising entrepreneurs of the West to go over and convert the raw materials into manufactured products rather than allow them to be shipped to foreign lands to be re-exported to India as finished products. This process will enable the Indian industrialists to gather first-hand technical knowledge and adequate experience from the foreign manufacturers' hands. Then only can a great impulse be given to industrialism in our country.

The industrial banks can purchase the total output and offer the same for sale in its depôts and the industrial banks would be justified in charging a slight commission for this work. They can also bring about the use of improved machines, tools and appliances by the method of hire-purchase system. Some such financial help is required in the case of several of our cottage industries if they are to be rescued from the clutches of the rapacious mahajans. Cotton weaving, brass and bell-metal industry, the cotton industry, the *chicon* and embroidery industry and the cutlery industry can be helped to a great extent if small industrial banks working in co-operation with the Industries Department of the Provinces are started on a large scale.

Again the industrial banks must realise that the Indian investors have no proper guide at present to direct their savings into productive channels. They lock up their savings in the Post Office Cash Certificates or invest them in unremunerative forms of employment. Such misdirection of savings and their wrong use should be checked and the industrial banks should stimulate the promotion of new industrial undertakings and carry them to a successful conclusion. India is capable of becoming one of the foremost industrial countries of the world if only the industrial banks can supply the needed enterprise and provide effective finance and induce for some time to come the required technical experts to come out from the West and settle

here. Our own capital is immobile and our business knowledge, technical skill and banking experience are limited and until there is a marked improvement in these lines, co-operation with British capital, British enterprise and British business knowledge is absolutely necessary. Our industrial banks should work in close harmony with the existing foreign industrialists and capitalists in our country and try to create the investment habit in the minds of our people. But finance is not everything in the matter of industrial organisation and its success. Industrial leadership is no less essential.

What the Government has done so far.

The Government of India professes sympathy¹ and has laid down as its policy the successful promotion of Indian industries. The delegation of industries to provincial control, the purchasing of stores in this country,² the appointing of a popular Minister in touch with the needs and aspirations of the Indian industrialists as heads of the Industries Department, the passing of Acts intended to outline the financial aid of the State to industries,³ the formation of Advisory Industrial Boards in the various provinces to help and guide the deliberations of the Industries Department are useful steps in the right direction, but the starving of the transferred departments is too well-known to need any repetition here.⁴ Without adequate

¹ The abolition of the cotton excise duties, the grant of State subsidy to the Tata Iron and Steel Works, the purchase of indigenous articles and the granting of increased funds for scientific research are unmistakable proofs of its sincerity towards the cause of our industrial development.

² A more enlightened policy of Government purchase of stores is inaugurated in 1928—Rupee tenders and preference to Indian Manufactures, without sacrifice of quality are its corner-stones.

³ Some of the Provincial Governments have lent to the different industrialists substantial amounts and in most cases they have been returned promptly. In several instances there were no assets to be realised and the Government lost the sums advanced. In other cases, even after reducing their claims they have been unable to reclaim their loans. But this policy of substituting reduced claims of lesser stringency must be followed uniformly so as to make the policy of reconstruction feasible. Such a policy is framed by the English Joint-Stock Banks. See the recent reconstruction of Messrs' Pearson and Knowles—Manchester Guardian Commercial, July 12, 1928 and September 1927.

⁴ It has been admitted that the Meston Award is responsible for this. Thanks to Sir Basil Blackett these contributions have been wiped away. But the industrial provinces like Bengal, Bombay and the United Provinces have very little resources left to them to be utilised for the nation-building departments. More resources should be

funds : even for the undertaking of scientific research in the several industries very little could be accomplished by the state in the direction of industrial development. The Provincial Governments have not however kept quiet in this direction. The starting of the Mining School, the Bengal Training Institute and the Calcutta Technical Institute are tangible proofs of the anxiety of the State to improve technical and industrial education in co-ordination with Indian industries. Something more has to be done in this direction. It should put an end to the differential treatment of European and Indian industries by the Railway Companies.² India need not go

granted to them so that they may discharge their duties properly and aid the development of national welfare. Only direct taxation is left to the Provincial Governments. Indirect taxation lies solely in the hands of the Central Government and it has also two of the most important direct taxes namely Income tax and Super Tax in its hands. The Provincial contributions of the Central Government have been removed altogether but no great relief has been secured thereby, for the industrial provinces have to meet ever-expanding items of expenditure with stationary resources. The Central Government should not encroach further upon the field of direct taxation. Again the transferee subjects should be given more money as soon as promising schemes of development are hatched by the ministers.

¹ So recently as in 1927 a resolution was moved in the Council of State urging the All-India Government " to set aside 50 lakhs annually for a period of ten years " for developing industries and carry out its duties with reference to industrial research, and the All-India industrial services such as chemists and engineers.

² The Railway Board has no doubt issued a circular on May 18, 1915, to the Railway Cos. pointing out that the development of industries would increase their business and that Railway administration should do much for the encouragement of industries by the quotation of favourable rates for the carriage of raw materials and of finished products. They were also asked to co-operate in making a special endeavour to do all that was possible for the encouragement of the Indian Industries. But the excellent intentions of the Government get whittled down to precious little while filtering through the administrative strata of the Railway Companies. Before the three Committees of 1918, 1921 and 1922, namely, the Industrial Commission, the Railway Committee and the Indian Fiscal Commission, several of the witnesses spoke disparagingly of the Railway Rates Policy. The Railway Rates Advisory Committee was instituted as a stop-gap measure and although it is too early to say anything of its usefulness, it cannot be denied that a machinery has been created to give a fair judgment as between the trade and the Railways and as soon as it bids fair to work successfully, its decisions should have legal binding on the parties and the status of the Railway Rates Advisory Committee should be converted into that of the British Railway Rates Tribunal or the American Inter-State Commerce Commission. Above all a rearrangement of the railway rates on a sounder foundation is the immediate necessity. The introduction of a through telescopic system for goods traffic over various railways as is prevailing in America is essential. Even the British Railways adopted this in 1921. It exists here only in the case of local traffic. Instead of forming too heavy reserves the reduction of rates and fares should continue.

through the long apprenticeship of patient trial, research and experiment by which the industries of the European countries have been built up. By engrafting on her economic system some of the features of Industrial Europe, she can have an "unearned increment." An industrialised India will be a tower of strength to the British Empire.

A Note on the German Industrial Bank.

The recently started German Industrial Bank should not be mistaken for a bank founding new industries or financing the existing German industries. It was created to act as an intermediary for the German industrial debentures, *i.e.*, collect payments of all industrial enterprises and pay to the Reichsbank to the credit of the Agent General for the account of the Trustee. The local reparation debt of 5 million gold marks has to be paid by the German Industrial enterprises and each industrial enterprise has to float the bonds or its debentures and deliver them to the bank. Each debenture is payable in gold marks and is issued in favour of the German Industrial Bank. Against these debentures the Industrial Bank issues 5% industrial bonds payable to bearer in two series of 2½ milliard gold marks each. The German Industrial Bank has a capital of 10,000,000 gold marks with its head office in Berlin. The managing board is of German Nationality and the Board of Directors is composed of 15 members. On February 28th, 1925, the Industrial Bonds were issued and there are about 60,500 assessed industrial enterprises responsible for the payment of the reparation debt.—See Bergmann "Reparations Payment."

The standardisation of railway revenue so as to secure the fixed contribution to the general revenue, the guaranteed interest, depreciation and other capital liabilities is also essential. The developing of railways in new areas and extending the technical improvements have also to be considered as equally important. The adoption of a unanimous rates schedule is long overdue and without such impetus, it is difficult for this country to secure industrial progress.

Similarly there is no use of merely reserving the Coastal traffic to the Indian shipping companies alone. Reduction of shipping freights is essential to enable the Indian Industrialists to enter the foreign markets and compete successfully with other foreign merchants or domestic producers of the foreign countries. The Meek Commission has failed to analyse how the shipping charge as an item of cost to be borne by the Indian Industrialist has been handicapping him in competition with Japanese products in markets of the Near East and Africa.

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CHAPTER X

MORTGAGE BANKS AND AGRICULTURAL CREDIT.

Era of Specialisation—Specialisation in the case of other banking systems—Necessity for mortgage banks—Legislation is no cure for the situation—The money-lender must become a modern banker—Urban Mortgage banks. The essential factors of credit—The function of credit in agriculture—Analysis of credit needs—Existing credit facilities in the country—Facilities in other countries—The example of Germany—The example of France—The example of the U. S. A.—The example of other countries—Recommendations.

Era of Specialisation.

The Twentieth century is a century of specialisation and the tendency towards specialisation is visible in banking business as in all other walks of our business life. The English banking system exhibits the specialising tendency to a very marked degree. The ordinary commercial banks or "cheque-paying banks" take up the business of attracting deposits and distribute their capital in loans, over-drafts and discounts. They make every effort to meet the short-term credit requirements of commerce, agriculture or industry.¹

¹ It is often stated in the United Kingdom that the commercial banks do not treat agriculture sympathetically as they do the urban interests. The disappearance of the old country banks and the extension of branches of big Joint-Stock Banks whose policy is guided by the London Board and the draining away of the rural deposits to urban areas for commercial and speculative purposes at home and abroad are considered as leading to the unsympathetic treatment of agricultural interests. The banks refute the charges of unsympathetic policy, unfamiliar managers and discrimination in favour of commercial investment and point out that more agricultural loans are outstanding to-day than in the case of small local and private banks. They point out that there is keen competition among the Joint-Stock Banks to develop the agricultural connection. Over-drafts, unspecified as regards purpose are frequently granted in preference to loan accounts. The old bank managers are still in office and local directors are recruited to help the new managers in the matter of studying local characteristics of business. Both in England and Scotland the banks have largely invested in loaning to agriculturists to meet their short-term needs. The sureties are conjointly and severally liable and are bound to the extent of the principle plus three years' interest. The rate of interest charged appears to be five per cent.—"Vide Report of the Chambers Committee on Agricultural Credit, see also Walter Leaf's Address—Annual General meeting of the Westminster Bank in February, 1923."

The discount business is specialised by bill-brokers and the big discount houses who run a much bigger book than the individual or running brokers. The acceptance business is looked after by certain merchant houses though to a certain extent the commercial banks are becoming the 'watch dogs' over the volume of acceptance. The British Trade Corporation was started in order to grant longer credits to industries and trade and any competition with the existing commercial banks is altogether eschewed by certain rules in its charter.¹ Besides these bodies there are other schemes of industrial and mercantile banks in London with regional banks for promoting foreign trade² and industry,³ international credit and discounting institutions. Mortgage loans can be secured through such well-known channels as private investors lending through solicitors and Insurance Companies. The Investment Trusts and Finance Companies conduct loaning business on mortgage of land, house or shop property. The Yorkshire Penny Bank and the Birmingham Municipal Bank specialise in attracting deposits of the poorer classes. Specialisation has extended so far that certain types of customers have developed the habit of conducting their business exclusively with one bank alone.⁴ Both long-term and short-term credit requirements of English industry and trade are now provided to a certain extent by special financial schemes devised by the British Parliament since the war. Though these were solely organised in the critical post-war years of financial and economic instability and unemployment they are still continued and extended for short periods in view of widespread unemployment existing in the country.

¹ The British Trade Corporation has proved a failure and the expected advantages were not realised to any large extent. It has become a part of the Anglo-International Bank.

² Among these the most important are the British Overseas Bank and the British Bank for Foreign Trade.

³ The Lancashire Banks are closely identified with the cotton industry. The most important of the Lancashire Banks are (1) the William Deacons Bank, (2) the Lancashire and Yorkshire Bank, (3) the District Bank, (4) the Manchester and County Bank and (5) the Liverpool and Martins.

⁴ An account with the Bank of England is considered as a Commercial Coat of Arms. Messrs. Coutts and Company was considered as the bank of fashionable society. It was recently amalgamated with the National Provincial and Union Bank. Cox and Company was regarded as the military bankers. It was recently amalgamated with the Lloyd's Bank.

Details¹ concerning the working of the Trade Facilities Act or the Export Credit Schemes² are surely out of place in a book on banking but the fact that the State had to take action which includes financial measures to promote trade and industries must be borne in mind. Similar transitory expedients must be resorted to at the outset when new industries are started in a country and it need not be stated that they should not be unduly prolonged. When private enterprise is incapable of providing sound long-term credits the need for exceptional State action has to be recognised.

Specialisation in other Systems.

The same specialising tendency is visible in the Japanese Banking. There are five different kinds of banks which deal with home trade, foreign trade, industrial business, agricultural business and

¹ The Trade Facilities Act was first passed in 1921. The Treasury at the advice of a small Advisory Committee of experts guaranteed the payment of interest or principal or both if the proceeds of the case were to be applied for capital undertaking and would promote employment in the United Kingdom. The loans are in practice made by the Insurance Cos., or Banks and the applicants are either public bodies or foreigners or citizens of the Empire as the case may be. This Act was extended to March, 1927, and about 75 l. M. worth of guarantee could be given by the State. Iron and Steel engineering, the ship-building, the building and the electrical industries were the chief industries that were promoted by this Act. The present Chancellor of the Exchequer is of opinion that the Act has exhausted its usefulness and it is not likely that it would be extended further—(Hansard, Vol. 94, Col. 53, 26th April, 1926).

² The object of the Export Credit Scheme is very wide for it aims not only at solving the unemployment problem in the United Kingdom but aims at the economic restoration of other countries. The Overseas Trade Act was passed in 1920 empowering the Board of Trade to make advances up to a certain amount on goods wholly and partly manufactured in the United Kingdom. In 1921 the method of guaranteeing the bills of exchange drawn by traders in respect of exports to countries including those of the British Empire has been allowed and in 1925 barring Persia all other countries were included in this scheme. Machinery and goods requiring long-term credits are financed by this method. The Credit Insurance Committee recognised the necessity of continuing this guarantee system and under the Trade Facilities Act of 1926 the period of guarantee was extended to September, 1929, and would remain in force till September, 1933. Exports wholly or partly manufactured in the United Kingdom including coal can be financed by this method of guaranteeing the payment at maturity of sterling bills of exchange drawn on the foreign importers. See the Report of the Credit Insurance Committee (cmd. 2619). British Exports to Argentina, Australia, Belgium, Brazil, Canada, Estonia, France, Germany, Holland, Italy, Spain, Yugo-Slavia, New-Zealand, Peru, Poland, Portugal, the Colonies and the Baltic States have been guaranteed under the scheme.



colonisation business. Besides these there are a large number of savings banks, ordinary commercial banks, and a large number of co-operative credit societies transacting business.

It is only in the country of Germany that the German Grossbanken perform a "mixed" kind of banking business. These German credit banks are, as Lord Inchcape styles them, "the clearing banks, acceptance houses, issuing houses, discounting companies, promoting syndicates or exchange bankers, traders and bankers." So the Economist puts it "the German banks are Stock, Bill and Exchange dealers and brokers, banker merchants, trust, financial and promoting companies."¹ Dr. Reisser has taken much pains to show that this has been due to historical conditions and that these 'credit banks' were called upon to help the process of industrialisation. But even in the pre-war days German banking illustrated clearly the extreme specialisation tendency. The different banking institutions can be roughly classified under the following heads, viz., the note-issuing banks of which the Reichsbank is the most prominent one, the credit banks known as the Grossbanken, private banking houses, twelve Overseas banks, thirty-eight mortgage banks, communal, urban, district and rural mortgage associations, agricultural credit banks, three thousand one hundred and thirteen savings banks, District municipal savings associations and Artisans and Farmers' Co-operative Loan Banks.

Our Banking System.

Although the system of Indian banking conducted on western lines is still in its infancy, it exhibits some signs of specialisation. The Imperial Bank and the Indian joint-stock banks finance the internal trade, the exchange banks deal with foreign trade and its finance. The Co-operative Societies and the P.O. Savings Banks try to encourage thrift among the poorer classes. A few industrial banks have arisen recently to finance industries but they are doing ordinary banking business. They unite deposit banking with different other operations. The task of keeping assets of a sufficiently liquid character in order to balance the demand obligations of

¹ See the Economist, October 21st, 1911.

a commercial bank is no slight one specially when operations partaking of a permanent character such as industrial finance are attempted. Many an authority has written deprecatingly of this tendency and points out that it only paves the way to commercial crisis.¹

Instead of combining such risky operations in the hands of a single bank, however pressing the necessity of a liberal financial assistance to our industries and agriculture might be, it would be better business if banks were to specialise in long term loaning. If separate financial agencies are created our banks need not like the German banks be nicknamed 'Alerlei enterprisen' and maids of all work or a kind of financial universal providers. However much our banks may be animated with a desire to emulate the bold and daring, yet fruitful, policy of the German banks, they should realise that the small amount of their paid-up capital, the low proportion of their cash reserves and liquid assets, the short-term nature of their deposits and the absence of masterly financiers, are real limitations warning them of the dangers involved in their ambitious programme to obtain absolute control over foreign trade, commerce and industries of our country.

Mortgage Banks.

The long-term credit requirements of either industry or agriculture have not been studied carefully. The mortgage banks of the joint-stock type or co-operative mortgage associations do not exist in this country. Sir James Meston, an ex-Finance Member of India divided the banking system into four departments. There is first general banking, secondly, the land-mortgage banks, thirdly, the co-operative bank and fourthly the industrial bank. Specimens of the first,

¹ W. R. Scott says, "there is an over-expansion of credit caused by the exchange of investment securities for cheque accounts and that a forced liquidation of these securities to meet the depositors' call entails a great loss and an enforced liquidation may bring about a commercial crisis." H. M. Geiger says, "that the practice of Commercial Banks to invest their sums has been one of the causes of industrial failures in the U. S. A. of several enterprising men who have seen their plans shrivel up and disappear under the sheriff's hammer to satisfy a note that has been called." C. A. Conant in his *Modern Banks* issue points out that the Bank of Italy, the Bank of Naples, the Bank of Sicily and the Roman Bank locked up in investments all their notes and failed miserably in 1892.

third and fourth kinds exist in our country. But the second one, namely, the land mortgage banks have only very recently been started but they have not become popular institutions as yet. Mortgage banks are included under the heading of Indian joint-stock banks and some of them like the Allahabad Bank, Ltd., and the Loan Companies of Bengal lend on equitable mortgage but there is not much of specialisation of this business done by them.

The chief reason why mortgage banks should be started is the fact that in the interior this business lies in the hands of the indigenous bankers and members of the wealthy class. Their terms are too high and exacting. The borrower is foolish and is exploited according to the urgency of his needs and nowhere does he get fair terms to which he is entitled by virtue of his security. Organised credit should be substituted in place of this acute and shrewd money-lenders. As Sir Frederick Nicholson said long ago, "the individual system of providing credit is too elementary and needs must make way to higher and more organised form of credit as general wealth, order, business-confidence and habits of association develop on the part of the people." These alone can eliminate the dangers of usury. No amount of tinkering with laws can stop it. There is at present the Usurious Loans Act of 1918 which attempts to give some protection to the borrower and the 1926 amendment has provided facilities for redemption of the mortgages. In spite of this stringent measure against usury the present system of professional money-lending is productive of bankruptcy, extortion from the borrower's property and other injuries to the rural community. Other classes also generally lend money on high rates. Greater powers should be given to the Law Courts to get behind any contract with a money-lender and after proper enquiry order a justifiable rate of interest. A high rate is justifiable only in such cases where the loan is unsecured or granted on personal security alone. The present system of lending does not take into account the financial standing of the borrower and in most cases it is a harsh and unconscionable bargain. The professional money-lenders must get themselves registered¹ and the charging of compound

¹ See Report of the Royal Commission on Agriculture, pp. 438 and 440.

² It is indeed difficult to secure this and the defect of the Punjab Money-lender's Bill in the Legislative Council was solely due to this difficulty.

interest declared illegal. Any rate above twenty per cent. is far excessive and this rate must be sanctioned by the Registrar. One great and incidental advantage of such procedure would be the opportunity to levy a six per cent. tax on the money-lender who now escapes taxation altogether. Another piece of legislation intended to check the land-grabbing tendencies of the non-agriculturist money-lender was to restrict the alienation of land and to see that usufructuary mortgages of land are to be limited for a definite period and the land has to be surrendered by the money-lender free of all encumbrances at the end of this definite period. The Royal Commission on Agriculture¹ has wisely insisted on the universal application of such law in the matter of usufructuary mortgage of land and its being limited to a period of twenty years.

Legislation is no Cure of the Situation.

It does not mean that legislation can cure all the evils of money-lending but well-considered efforts are needed to mitigate the existing evils. These measures would doubtless have popular approval and support. Like the American Bankers who in order to evade usury laws charge the maximum seven per cent. interest and add "commission," "fees" and "bonuses" and the like to obtain a high return for their money² so also our bankers can evade the Usury laws in several ways. The old Agency Houses of this country similarly evaded the interest law of this country and exacted roughly 20 to 24 per cent. rate of interest from the indigo planters. As much of the agricultural indebtedness is settled out of the Civil Court and the borrower seldom takes advantage of the law of limitation much relief cannot be secured by legislative measures limiting the rate of interest. Hence it is not possible to suppose that the interest laws of the Government would be widely appreciated by the agriculturists. Finally a vigorous carrying out of the usury laws would restrict some of the existing avenues to the agriculturists for obtaining the needed credit.

¹ See p. 419, para. 353.

² See Ivan Wright, "Bank Credit and Agriculture," p. 238.

*Money-lenders must become Banks.*

Our efforts should therefore be concentrated in the following direction. Firstly the co-operation of the rural money-lenders must be enlisted. They should be made to lend to the short-term Co-operative Societies or Co-operative land mortgage societies alone or start banks of their own. The Government need not guarantee the payment of interest on their capital. On loans he makes he can secure seven to eight per cent. rate of interest. He would secure interest on deposits forthcoming which might be reckoned at three to four times his own capital and if the method of securing loans is made easier for them than at present they would willingly join the Co-operative credit movement or become pure bankers devoid of the interest and necessity to exploit the borrower. These Co-operative Societies or land mortgage banks must also arrange to dispose of the produce created to consumer's Co-operative Societies and secure the rural necessities through their co-operative purchasing agencies.¹ These village land mortgage banks might buy shares in the central land mortgage banks of the District which might also be federated into provincial banks. Regular banking must thus be provided in the moffusil areas under the aegis of the land mortgage banks and co-operative credit societies. These should collaborate with the other Agricultural Co-operative Societies.

Secondly, the State can do something in this direction. It can confer honorary recognition on the indigenous bankers who undertake to co-operate and work these land mortgage banks, stimulate the banking habit and spread genuine banking business among the urban and rural areas. The State generally confers a certificate of merit on Presidents of Village Unions for their good work in connection with the Union Boards' work. As the sociologists tell us "what is honoured is cultivated." The monetary motive alone does not explain the human urge. In China the native government has recently inaugurated the policy of granting medals to all those women who invest in industries or industrial banks and forsake the habit of adorning themselves. Such ladies are to be decorated

¹ See Special Resolution II, on Agricultural Co-operation, by the World Economic Conference.

with Phoenix medals (Wen Fang Chang). The 1st class medal is to be awarded for the investing of not less than 200,000 \$ to 1,000,000 \$; the second class to those who invest smaller amounts themselves or raise \$ 5,000,000 or more. So medals are awarded to women for investing in industries. Some such methods have to be pursued by the Indian government and it can be confidently stated that several of the indigenous bankers would undertake regular banking business. Public approbation would act as a sufficiently strong incentive for greater activity in this helpful line. It is high time that India should inaugurate a Board of National Investment and the Seva Samities can undertake to work in co-operation with it. The employers and the Banks can also undertake to encourage this movement. It would have a powerful influence in securing the needed funds for our agricultural industry. Cheap yet not facile credit would shape the lives of the urban masses in a healthy way.

Urban Mortgage Banks.

The object of these urban mortgage banks should be the redemption of ancient and oppressive private mortgages by the granting long-term loans at moderate rates of interest. When a number of such institutions transact business the present abnormal rate of interest will be reduced and it will break the monopoly of the usurers. Their business is to grant mortgage credit without requiring any declaring of the object or purpose of the loan. These should resemble the small joint-stock banks of Switzerland. A big mortgage bank situated in a populous city may find enough employment for its working capital and it may not condescend to transact business in rural and other urban centres. Urgent help is needed in rural parts also and city capital should necessarily be shifted to these parts. The union of city and urban economic forces with those of villages is absolutely necessary.

It is sheer folly to consider mortgage business as the road leading to ruin. This is not true in every case. Sometimes it might so happen that a man's capital gets locked up in land, houses and stock. If it has to be temporarily mobilised for an occasion, raising credit by mortgaging the property should not be objected to, nor

should mortgage at such a time be considered a sign of weakness. But if this borrowing is not temporary mobilising of capital but is chiefly due to improvidence and recklessness it is to be condemned as necessarily leading to ruin. But so long as a fair and equitable proportion is maintained between the liability and the assets and the rate of interest is not too high to be covered by the rate of return out of the use of the borrowed money, mortgage builds a fortune for the borrower and there is no reason to repent for the transaction. In all advanced countries including Denmark the land is mortgaged and credit is obtained for productive purposes. There is no ignominy attached to any of these borrowers in any of these countries for this kind of credit secured on the mortgage of their property.

The mortgage banks should be welcomed for their competing capacity with the money-lender.¹ As Sir F. Nicholson emphasized long ago "competition is the only way of bridling the money-lender." He must be of no account in the general credit system of the country. The competition of these banks would knock down the present high rates of interest. But it must be remembered that it is not the urban people who are the chief sufferers on account of the absence of these mortgage banks. They are no less essential for the agriculturists.

Agricultural Credit.

Economists have analysed credit into two factors, namely, confidence and time. Credit means the repayment of ready money to a solvent individual in the expectation that it would be returned in the future along with interest which is only a compensation to the owner for foregoing the use of capital. Credit thus benefits both the holder of capital and its borrower. Hence credit could easily become the corner-stone of the industrial, commercial and speculative aspects of our business life. It has received rapid extension in all walks

¹ Sir Daniel Hamilton says, "the interest rates of 30-60 per cent. due to the indigenous banker must be barred." He is so emphatic in the condemnation of the indigenous banker that he says, "what India wants is an act written not with a goose quill dipped in milk and water but with an iron pen dipped in the blood of the Mahajan for until the banking system for which the Mahajan is responsible is dead India will not live"—*Vide* Souls of Good Quality and other papers.

of life and it would be impossible to enumerate the different lines in which its services are requisitioned in civilised countries. One curious fact noticeable even in the advanced countries is the small use of credit in agriculture till a comparatively recent period. But it has already become as important a part of his business as his scythe, his cattle, plough, etc. In the entire chain of events from sowing down to selling the crop, the help of a sympathetic money-lending agency is necessary.

The Function of Credit in Agriculture.

Credit is needed for the agriculturists both for short as well as long periods. So long as agricultural business is not understood as providing essentially for a market but is conducted purely for family needs of the agriculturists living in a self-sufficing economy stage much capital is not needed. Improved seeds, fertilisers, improved cattle and better ploughs are required if agricultural production is to expand. These require an outlay of money and there must be some credit organisation to satisfy the different credit needs of the agriculturists in a suitable manner at a low rate conducive to the prosperity of the agriculturists and on the security that the agriculturists possess. Better farming and better rural business conditions would be denied if it is difficult to obtain sufficient credit at a cheap rate. An elastic rural financial system is necessary for the economic welfare of our agriculturists. Without it no capital can be sunk for irrigation, for manures and for efficient tillage instruments. There would be no increase of harvest, no thorough scientific exploitation of land, no reserve working capital and no lowering of the costs of production.

Analysis of Credit Needs.

The funds required for agriculture are of two kinds. Fixed capital is essential to make permanent improvements in land, to wipe off the existing indebtedness secured by the mortgage of the land, to purchase cattle and to obtain a steady water-supply by sinking wells. Circulating capital is necessary to keep the farmer in growing, harvesting - making current outgoings and marketing his

crops. Fixed capital can be secured by real estate mortgages which can be made payable out of annual returns from the land. Other means can safely be employed to provide the short-term credit needs. But as India is unfortunately dependent on the monsoons there is very often a failure of the crops once in five years and during the lean years the provision of current outgoings is always difficult and the securing of capital to begin agricultural operations at the next season is rendered acute. Credit for such purposes must necessarily be of a longer period than short-term periods for growing, harvesting and marketing the crops. The repayment of credit for the intermediate period need not be spread over a long period as in the case of fixed capital sunk in permanent improvements in land.

Existing Credit Facilities in this Country.

It is imperative to examine the means available for the agriculturists to obtain credit for enabling them to continue seasonal operations in agriculture or to enable the agriculturists to effect some improvements on their land such as the adopting of machinery or improved appliances, modern scientific methods of farming, the building of a financial reserve against low market prices and the allowing of the land to lie fallow, the raising of better breed of cattle and the experimenting with other than the cheapest manures and the insurance of cattle.

The present system of financing the agricultural industry either for short-term or long-term needs is partly good, partly indifferent, and very inadequate. The existing financial agencies are the village money-lenders, the co-operative credit banks, the Government directly granting loans and the Zemindars owning the land.

Coming to the money-lenders' methods it must be emphasized that as an agricultural banker he is an absolute failure. He is not interested in agriculture and measures for agricultural progress do not appeal to him. He does not insist on prompt repayment in small sums. He is generally unsympathetic towards the sad plight of the agriculturists. His rate of interest is usually high. He keeps no carefully kept register which is subject to independent outside audit. Some of the professional money-lenders are unscrupulous and attempt to foreclose mortgages so as to obtain the farm below its

market value. The crop lien which is one form of security accepted is a vicious system subject to grave abuse. The agriculturist loses his independence and pays an enormous amount of interest as a result of the way in which the crop is manipulated by the money-lender. This system of continuous financial slavery can be evaded only when an unusually heavy price has been realised but it is very often the case that the agriculturist is seldom lifted out of debt. This form of credit is granted for current outgoings. The village money-lender is also the supplier of necessities and the agriculturists pay heavily for them. This uneconomic, illegitimate and impoverishing kind of credit has to be changed. It is unwise to condemn the misuse of intelligence and the legal opportunities on the part of the money-lender for the money is lent often but for unproductive purposes on securities of doubtful value. A banking agency should however displace this unsympathetic credit-providing agency.

A more sympathetic lender of credit than the village money-lender is the Government of India. In addition to the indirect method of financing agriculture by facilitating the co-operative movement the Government of India has tried to finance agriculture by direct methods. By the Land Improvement Loans Act of 1883 loans can be made to the agriculturists for making improvements in land by sinking wells, cutting channels and purchasing agricultural necessities as seed, cattle and implements. The Agriculturists' Loans Act of 1884 enables the Government to lend for general purposes and under such conditions which are usually followed by the co-operative credit banks.

Certain improvements are being introduced and the co-operative bank is being utilised as the channel for repayment of the loans. The attempt to make the co-operative societies or banks manage the loans which can be made by the Government under the Act of 1884 would introduce a desirable innovation for it leads to the freeing the Government of certain responsibilities and would at the same time confer prestige on the local co-operative societies.

These Acts have failed in their duty for very few individuals alone can be benefited. To secure these loans the borrowers have to fawn upon the officers whose rapacity forces them to deduct substantial sums from the original loans made by the Government. The



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process of obtaining loans through this machinery requires much time and as prompt repayment is insisted upon by the Government the loans prove to be unattractive to the agriculturists who have to subject themselves to several inconveniences. As the Moral and Material Progress Report of 1911 observes "these loans though large in the aggregate have not had any great influence on the agricultural credit of the country." Although the Royal Commission on Agriculture attempts to justify the rules with reference to interest rates charged on the Government "loans on the ground that they are based on rates offered for public loans" still it must be tacitly recognised that the relief the Government can afford will not only be limited in amount but the Government cannot act as a suitable financial agency to the agriculturists.

The management of the co-operative credit societies has produced very good results. It is an undisputed fact that they form a substantial contribution to the solution of short-term credit requirements of the agriculturists. The recent World Economic Conference organised under the auspices of the League of Nations admits that "the best form of institution appears to be the co-operative credit society operating by means of resources which the very fact of association enables it to procure and to increase with or without the assistance of the public authorities." The fascinating growth and real progress of the co-operative credit movement cannot be doubted by the most sceptical of its critics. But as the ideal temperament and requisite character required for its success are not to be found in all men some mistakes have crept in unconsciously. It is not only essential that these should be checked as early as possible but it should be realised that the present form of activity is suitable for the short-term credit needs of the agriculturists and it has to be supplemented by other co-operative organisations which provide the long-term credit resources needed by the agriculturists. Government aid has to be supplemented by private aid and mutual help in the matter of developing a suitable agricultural credit organisation. Co-operative finance alone possesses all the desirable characteristics of agricultural finance as outlined by Sir F. Nicholson.¹

¹ See his Report on Land and Agricultural Banks, Vol. I, p. 3.



A commercial bank is generally intended to facilitate the exchange of things of definitely ascertained value already in existence. The shortest period needed for agriculture is too long for commercial banks. Agricultural pests, diseases of crops, storms and price fluctuations may reduce the value of their non-liquid security. Thirdly the Indian agriculturists are bad bank customers. The small size of their farms, the non-transferable occupancy of the holdings, their unbusinesslike habits, and lack of education are serious handicaps. Lastly the Indian commercial banks find ample scope and outlet for their funds without catering to the agricultural interests. It is impossible to finance landowners by the deposits of commercial banks. This would force them to call in the loans at any inconvenient time for the agriculturists.

Barring the Dawson's Bank operating in the Irrawady Delta of Burma there are no agricultural banks in the country. But the success of this Bank¹ is due to its first mortgage security, secure and readily marketable harvests, valuable land, proper supervision of borrowers' application of loans for productive purpose, prompt collection of interest and loans on system of instalment and the absence of competition. Without such an ideal environment the agricultural banks are bound to fail.

Lastly the enlightened Zemindar is another source to whom the agriculturist can appeal. But most of these are heavily indebted and much cannot be expected from the absentee landlords. The system of co-shares in landed property itself acts as a deterrent in the matter of investing on land and even the more educated landlords seldom do anything in this direction on lines followed by the English landlords.

Facilities in other Countries.

All progressive countries have made distinct and elaborate provision for financing the different credit needs of the agriculturists. Germany was one of the first countries to develop elaborate and well-planned credit machinery for financing the credit needs of the

¹ See the Report of the Royal Commission on Agriculture, p. 422.



agriculturists. The old and the new Landschaften of Germany ¹ have been used as the model for the latter-day credit developments of other countries. The Landschaften and the Credit Foncier of France have been the models on which other countries have based their mortgage credit banks for agriculture.

The Landschaften of Germany are long-term land credit banks which were first organised about the end of the eighteenth century. They were co-operative banks formed by the landlords of a province with the main object of obtaining credit for making permanent improvements on land. The collective mortgage of land furnished the needed security and the unlimited liability attached to the members enhanced the value of the security, *i.e.*, the bonds sold to the public. The executive committee managed the business and those who had the requisite legal knowledge got payment for their business services while others had only travelling charges alone for conducting the business of the banks. The Government inspected the banks. The new Landschaften are ordinary mortgage banks but they possess no share capital earning dividends. They are merely syndicates of landowning borrowers acting as intermediaries in providing capital on the basis of the guarantee which however is granted after proper testing of the credit of the borrower and the value of the security. These charge only $\frac{1}{4}$ per cent. commission for this service. They are confined to definite localities and the officials know the men and the land values throughout the district. The loan is granted usually to a limited extent of the value of the land. These banks are the agencies through which the bonds based on the land are sold. As these debentures are based not only on the specific piece of land but by the mass of mortgages floated by the society. If interest is not paid the debenture-holder can request the court to set aside specific mortgages to pay the due interest. There is no right to demand payment on the part of the debenture-holder but the banks can withdraw them and make provision for repayment. The four per cent. debentures are sold above par and as cheapness is the object the old debentures are recalled and fresh ones issued at a low rate. Loans are repayable by amortisation payments usually

¹ See H. T. Herrick, "Rural Credits," pp. 1 to 210. See also the miscellaneous articles on German Banking published by the American National Monetary Commission.



in about 53 years. A slight contribution towards reserve guarantee fund and expenses has generally to be made along with the amortisation payment and the amount of interest. The working fund is formed by contributions made from the expenses of management and any special resources. These banks have the right to take possession of the property and force a sale without resort to regular foreclosure proceedings. They are manned by semi-official officers who are endowed with judicial and executive powers on all matters concerning the banks and the member borrowers. Heavy penalty can be imposed for any infringement of the rules. The Central Landschaften was created in 1893 which buys the debentures of Provincial Associations taking an assignment of the underlying mortgages and issues its own debentures which find a ready sale in the money market. The cheap system of credit has made it possible for Germany to create landowning farmers. In other countries like England, Japan and France where no such elaborate credit system exists the landowning farmers are only the exception. "Even France, the classic land of the peasant proprietor, has only 52·8 per cent. of its land cultivated by the land-owning cultivators," remarks Morman.

In modern Germany agricultural mortgage credit has been rehabilitated to a great extent by placing suitable public money for long-term investment in their line. The Postal service and some of the social funds have utilised their resources in this direction. The Gold Disconto Bank has taken up mortgage bonds worth 100 ms. marks from the Rentenbank Credit Institution. The individual private and public mortgage Banks undertake to distribute this credit through their agency and the farmers pay only 7½ per cent. The official Pensions fund of the Reichsbank was invested to the extent of 80 ms. marks in agricultural mortgages. Mortgages are admitted as collateral for loans and the percentage of collateral for loans was raised from 50 to 75 per cent. In May, 1926, the Reichsbank declared its willingness to back short advances made by the Central Organisation of Prussian Co-operative Banks on stored grain.¹ This measure enables the agriculturists to withhold from selling the harvest at disadvantageously low rates.

¹ See Dr. H. Schaaf, "The Stabilisation of the Mark," pp. 203 to 210.

*The Example of France.*

The Credit Foncier of France was started in 1852, and remodelled in 1854. It acts as the apex bank for the mortgage banks in exactly the same manner as the Central Bank of France does for the commercial banks of the country. It enjoys special legal privileges granted to it during 1853 and 1856 besides being closely supervised by the Government. The Government appoints the Governor and Deputy Governors of the Bank. Government Treasuries are to be used for receipt of its dues, deposits and surplus funds. It has to pay reduced stamp duty on deeds of registration, transfer of debentures, etc. Even trust funds can be invested in these debentures. No registration of its debentures at the end of every ten years is needed. This bank by its system of "purge" can bring to light any hidden claims on land and free the title of the real estate from all possible claims of third parties. Its debentures are repayable to bearer with no fixed time of maturity and repayable with bonuses and prizes. It need have no recourse to ordinary foreclosure for recovering its loans. Its loans are the first lien on land and the maximum rate of interest it can charge is five per cent. Mortgage loans for long as well as short periods ranging over ten years can be granted by it. It is privileged to make any system of loaning for agricultural improvement after securing the required sanction of the Government.

It founded the Credit Agricole in 1860 which however was absorbed in 1877 by the Credit Foncier itself. In 1882 it brought up the Banque Hypothecaire and at present the provision of long-term credit is made through regional banks which guarantee the loan and on the mortgage of land the loan is made repayable within the course of 25 years. From 1910 even private individuals are allowed to secure loans to improve their rural properties through these regional banks. Loans up to 8,000 francs can be made and are repayable within 15 years. In 1920 this system was extended, the maximum loan was fixed at 40,000 francs repayable at the end of 25 years and the maximum interest for the loan is 2 per cent. The regional banks are to observe a proper distribution of their resources between short-term credit (25%) intermediate credit (10%) and long-term credit to individual small holders (32½%) and the remainder in long-term



credit to societies. The regional banks can lend their capital and reserve for short-term credit purposes. There is additional legislation improving the National Office for Agricultural Credit to set aside 600 ms. francs for encouraging and distributing electrical power in rural districts. Agricultural Savings Banks are organised to encourage rural inhabitants to pay an old age annuity and the local Agricultural Credit Fund undertakes all the legal operations in connection with these Savings Banks, transmits funds to the National Office Age and the L. I. funds. The agricultural credit system is thus made to act as a useful clearing house for a system of old age savings. Ex-service men are given special facilities to settle on land and to invest their gratuity of 5,000 to 10,000 francs in such a holding. Long-term loans are granted to them by the Land credit fund.¹ Throughout the most noticeable feature is the emphasis levied on long-term credit for agriculture and this system has proved a complete success. If India can hope to encourage its rural population by means of small holdings, it is essential to see them organised on a co-operative basis for securing credit.

The Example of the U. S. A.

The United States of America realised the importance of agriculture so long ago as 1800. The Federal Government made provision for the capital required to enable a farmer to purchase land and carry on his operations. For about twenty years it disposed of public land on a credit system. But till 1863 no serious attempt was made to establish sound banks to finance agriculture. The so-called "wild-cat" banks issued their notes during this period but the resulting chaos was so great that the National Bank Act had to be passed. This Act did not confer any *special* privileges on the farmer but there was no discrimination against him. But as the initial capital required for starting a National Bank was fixed at \$50,000 the farming districts could rarely afford to gather so large a sum. The law relating to the loaning business also condemned the making of loans on real estate. The State Banks which were hitherto supplying rural credit were impeded by the levying of a ten per cent. tax on their

¹ For having a complete view of the provisions of 1920 reorganisation see the I. L. Review, 1925, June no., pp. 852-854.



note issue. Since 1900 the banking law was amended to favour the farmer. (A) The minimum capital required for starting a National Bank was reduced to \$25,000 for towns with inhabitants below 3,000. (B) In 1912 the National Banks were empowered to lend on real estate to the extent of the capital *plus* the reserve or 30 per cent. of their time deposits. (C) The Federal Reserve Act authorised the F. R. Banks to rediscount nine months agricultural paper. In 1916 the Federal Farm Loan Act was passed. It instituted twelve Federal Land Banks in selected districts. Each was to start with a capital of \$ 250,000 partly financed by the Government. The Federal Farm Loan Board appoints four Directors (the Secretary of the Treasury being an *ex-officio* director) to control the whole system. 4,500 National Associations were started and each Association consisted of about 10 or more land-owning borrowers who subscribed 5 per cent. of their loan in stock which carried double liability with it. These Associations combined to start the Loan Bank and guaranteed the mortgage and each Federal Land Bank has to guarantee the bonds and coupons of others. The bonds floated by the Federal Land Banks are tax-exempt and are eagerly subscribed for by the public as the Federal Government closely supervises the issue of the bonds and sees that no Federal Land Bank floats beyond twenty times its capital and reserve fund put together. The bonds are in denominations of \$50, 100, 500 and 1,000 and in larger denominations payable any time after the end of 10 years if the F. L. Bank elects to do so.¹ Loans are granted as first mortgages up to fifty per cent. of the value of the land and twenty per cent. of the value of permanent insured improvements on land. The loan period ranges from 5 to 40 years and the loan is repayable on an amortisation principle.²

So far as short-term and intermediate credit are concerned the Federal Reserve Banks can rediscount agricultural paper repayable within nine months or less. An indefinite number of joint-stock land banks have also been organised. In the north and north-western parts of the United States of America the local and state banks furnish credit to farmers on personal notes, chattel mortgages or other

¹ See the Year Book of the Department of Agriculture, 1925 (Washington).

² See J. B. Morman, "Farm Credit in the United States of America and Canada."



acceptable security. Farmers own these land banks and operate them mainly with the idea of securing credit for genuine rural improvement purposes. The rating of the agriculturists' credit is being discussed and when this is accomplished the banks can safely lend on agricultural paper. Trust and insurance companies also conduct long-term loaning or farm mortgage business. In 1921 the War Finance Corporation was empowered to finance the export of agricultural produce and to meet the long-term needs of the agriculturists for a further period than 6 months and up to three years. A permanent live-stock loan system is being organised to fill in the gap that would be created by the dissolution of the W. F. Corporation. In 1923 twelve Federal Intermediate Land Credit Banks were started to finance the agricultural needs which would be of short duration and do not warrant the long-term credit of the Federal Land Banks. Thus within a period of fifteen years an elastic rural system of credit was created as a check against hard days and unreasonably low or declining prices of agricultural produce. These loans can be repaid as times get better. In addition to this Federal Government's solicitude, the states also make provision for granting long-term loans on mortgage to the agriculturists. The money for this is being secured by the sale of public lands. State Land Banks have been started in New York, Missouri, Colorado and Indiana. South Dakota and Montana are attempting to build a rural credit system in which funds have to be loaned on farm mortgages to be secured through the sale of state bonds.

The Example of other Countries.

It is not these old established countries alone that make proper provision for agricultural credit. Every newly settled state of Central Europe has made elaborate provision for agricultural credit both for long as well as short-term periods. In Czechoslovakia the Act No. 166 of March 1920 systematises this state help. Loans up to nine-tenths of the purchase price of land and one-half of the value of acquired buildings can be borrowed. A specified bank for making these ~~loans~~ was created in 1923. Short-term loans are made direct to the Co-operative Societies by the Land Office or to individuals through a Co-operative Bank on the surety of the Land Office. About 81,000,000 Crowns were lent by the state while the private banks could lend only



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50,000,000 crowns. In Jugo-Slavia an Agricultural State Bank has been formed for financing the short-term and long-term credit needs of the agriculturists. In Palestine the British Government has been organising a plan for starting a long-term credit bank.

The Dominion of Canada perfected its arrangements for agricultural credit in 1917. The Farm Loan Act organised a fund of \$1,000,000 of which the Crown is empowered to subscribe one-half and advance the other half till the borrowing farmers who alone can be shareholders come in gradually. A Committee of five manages the loaning business. Fifty per cent. of the value of land can be lent as a loan which can be repaid within thirty years. The interest on the loan is six per cent. The loan is repayable on an amortisation payment. The Committee is its own conveyancer in granting, hypothecating and cancelling mortgages. Loans are to be made for improvements on land. Cash can be raised by attracting deposits carrying four per cent. interest and issued to the public in various denominations ranging from Rs. 25 to Rs. 1,000 withdrawable at any time. Bonds for larger sums are issued carrying interest of five per cent. and these are secured by mortgage granted up to ninety per cent. of the land value. The bonds are repayable by the end of the first year from the date of purchase. Both deposits and bonds are tax-free and are issued under the liability of the province. The Rural Credits Act supplements this Act and makes possible loans on personal security. Both these services are likewise considered to have proved successful. In Australia the Commonwealth Bank has a separate rural credit department for "granting loans for short periods on primary produce" to corporations or associations engaged in agriculture.¹

So far as the Union of South Africa is concerned the Land and Agricultural Bank was started in 1912, to extend help to agriculture. Act 40 of 1926, extended the power of this Bank to raise and use these funds for financing Agricultural Loan Companies and Rural Credit Societies.² The Central Board of the Land Bank can render other services to these rural credit societies in the direction of storing agricultural produce on which loans have been granted by

¹ See "the Commonwealth Bank Rural Credit Act of 1925."

² See Sec. 33 of the Act 14 of 1926, the South African Union Parliament.



the rural credit societies and in lending banking officers to organise the work of the rural credit societies.

Switzerland,¹ Sweden, Russia² and Denmark also possess land banks specialising in the granting of long-term loans. In Bulgaria the Central Co-operative Bank has two departments, one for insurance and one for credit. The funds for the credit department are supplied by the National Bank of Bulgaria, the State Credit Institute and the Agricultural Bank of Bulgaria. In Argentina there is a highly developed system of land mortgage banks. In Hungary and Denmark the land mortgage banks are flourishing institutions.

In Japan there is an efficient system of land credit. Long-term agricultural financing is entrusted to a special Bank known as the Hypothec Bank of Japan (Nippon Kwangyo Ginko) which was founded in 1895 with an authorised capital of Yen 94,000,000 and it has a paid-up capital of Yen 69,876,000. It was modelled on the Credit Foncier of France and its sole business is to make long-term loans redeemable during fifty years on security of immovable property. Without security it can lend to the co-operative societies and public authorities. It can raise additional capital by floating debentures. Both the President and the Vice-President are appointed by the Government from among the directors, and the Minister of Finance has a general control over the affairs of the Bank. He has the power to fix maximum rates of interest. Agricultural and industrial banks were established in each prefecture between the years 1897 to 1900. Part of the capital was subscribed by the shareholders and the remainder was paid by the prefectural authorities. They were solely meant to act as the local advisers of the Hypothec Bank. Like it they float debentures but they are essentially miniature banks drawing funds from the Hypothec Bank. In 1921 several of these were amalgamated and were treated as mere branches of the Hypothec Bank.

¹ In Switzerland there are 28 institutions of mortgage credit either belonging to the State or working with State support.

² A good account of the Nobles' Government Land Bank in Russia can be obtained by consulting the monthly Bulletin of Economic and Social Intelligence for Sep. 1914, p. 77 *et seq.* At present the Central Agricultural Bank undertakes the duty of helping the farmers to purchase live-stock, seeds and secure improvements of land. It receives help from the State. It carries on business through the agricultural credit societies. See S. S. Katzenellenbaum, "Russian Currency and Banking," pp. 186-188.



Even in disorganised China, as it appears to be, there is an organisation of labourers and farmers' bank in every Hsien District of the Shansi Province which was started in 1920 by the Provincial Assembly. The capital of the Bank is graded according to the population living in the district. Two-thirds of the capital is to be made up out of subscriptions. The remainder is to be paid out of the Treasury. Loans are to be made to farmers and labourers. The Bank is also permitted to receive fixed deposits to accept instruments for safe-keeping and act as fiscal agents for local officials. A loan is limited to \$500 per individual or \$1,000 for a corporation. The interest rate is fixed at 1 per cent. per month. Bonds can be issued to two times the amount of capital with the permission of the Ministry of Finance. There are a number of such banks in Taiku, Kishien, Wenshai, Fengyang and Yungning.¹

Quite recently the Parker Willis Commission of the Irish Free State has recommended the establishment of a big Agricultural Credit Corporation with a capital of £500,000, the unsubscribed portion of which is to be allotted to the State and the commercial banks. Bonds and debentures issued by it are to be guaranteed both for principal and interest amounting to £1,000,000 in any year. Besides it has to act as a Clearing House for local co-operative credit societies, co-operative creameries, other co-operative marketing organisations and co-operate with the I.A.O. Society. Lending to individuals or groups of farmers can be done only for securing improvements in land. It can rediscount bills or securities in the open market. It can also administer Government agricultural relief measures. But above all it is incumbent on it to specialise in the business of providing long-term capital to agriculture.

Even in England the Committee appointed by the Ministry of Agriculture and Fisheries which has issued its report in April, 1926, makes provision for long-term credit. A Central Land Bank should be created for making long-term mortgage loans through the joint-stock banks and the branches and to raise money for this purpose by the issue of debentures to the public. The Bank is to be empowered to lend money up to a prescribed period upon the first mortgage upon agricultural land and buildings. A chattel mortgage

¹ See the Mysore Economic Journal, 1926, p. 127.

on farm crops and livestock should also be created. It should be empowered to issue debentures to the public based upon these mortgages up to a fixed proportion of its capital and surplus funds, thus creating a recognised means through which capital might be invested in agriculture. Loans would be made through the Joint-Stock Banks and their branches which would act as the agents for the Central Land Bank.¹ Similarly provisions for short-term credit have also been perfected.

Besides such specialising agencies for granting mortgage credit other agencies also conduct this business in almost all the advanced countries. In the United States of America joint-stock Land Mortgage Banks also lend for long-term purposes. These are privately owned but are supervised by the Federal Farm Loan Board. The Trust Companies, the State Banks, and country farmers and money-lenders grant credit to the agriculturists. In Germany besides the *Landschaften*, joint-stock mortgage banks, savings banks, and improvement annuity banks grant long-term credit to the agriculturists. In France the joint-stock mortgage banks, and the savings banks also undertake this long-term loaning to agriculture. In England the joint-stock banks with branches in inland districts, land Companies and private lenders grant the long-term credit.

Recommendations.

It will be convenient to summarise what has, in a somewhat platitudinous manner been dealt with in the above paragraphs. The main issues to which attention must be directed are:—

(a) The introduction of special agencies for the provision of long-term financing of the agriculturists.

(b) The Government of India should do something to improve the credit situation of the agriculturists. It is indeed true that it

¹ Since these lines were written it was proposed to start a land mortgage corporation under which the Bank of England and other joint-stock Banks are to subscribe a part of the capital. The state is to guarantee £750,000 capital, to under write £5 ms. of debentures and to invest £1½ ms. in the debentures to be issued and to make a contribution to the costs of administering the scheme. The recommendations on short-term credit of the 1927 report are accepted *in toto*.

is not the duty of the State to provide money to assist private enterprise. Sir James Meston, an ex-Finance Member of the Government of India, remarked that the land mortgage banks would be of much value to this country. "Everybody will recognise that it is a very different sort of institution from the ordinary commercial bank. It must be an institution which is financed very largely by long-term deposits in order to ensure that it shall not be embarrassed in its handling of advances to landlords and estate holders. It is a type of bank which I do hope to see established in this country but I hope to see it done in every province started very largely by local enterprise and maintained under local supervision and control. It is the local knowledge and neighbouring control by groups of intelligent landlords that are going to make the land mortgage business in this country a success and I do not think that it is of any use for the Government to undertake work of this sort on a large scale."

But certain special features of the Indian agriculturists should be considered. Those who have sufficient landed property and security to be included in a system of mortgage banking are often sleeping partners having no inclination to borrow while those who do want to borrow are without any security against which debenture loans can be floated. The deep importance of flourishing agriculture to the State needs no emphasis and the prosperity of agriculturists cannot be secured without any efficient and economic organisation of the industry which includes properly organised financial assistance as an integral part of it. Taking some of the above examples of other countries into consideration we find that the State has to do the needful in providing special and permanent machinery to facilitate the provision of long-term credit for the agriculturists. Our agriculturists are so sunk in ignorance and their methods of life are so different that they often fail to make out a case for themselves. It is erroneous to expect that the debt-ridden landlords would do everything in this direction. Several of the provinces have done the needful in this direction by helping the starting of the land mortgage banks and they have been giving the needed impetus for the formation of private institutions of landowning agriculturists for the purpose of obtaining loans at cheap rates for the members on the common security of all. But there is no systematic organisation and they have

not obtained any proper place in the Indian Banking system as a whole. A close-knit organisation specialising in the domain of long-term agricultural financing and co-operating with the existing co-operative credit societies which have to confine their activities solely to short-term and intermediate credit of the agriculturists must be created in place of the present drift towards long-term financing of agriculture in this country.¹

For the present the movement is confined towards the floating of land mortgage banks for securing long-term credit for the land-owning agriculturists only. But it is the duty of the State to float mortgage banks to help the agriculturists, *viz.*, tenants who have no right in land. The Provincial Co-operative Land Mortgage Bank can float bonds on its own general assets and as land cannot be utilised as the specific basis of these tenants-mortgage-banks a change in the method of procedure is essential. Security other than land can be taken from the tenants who do not possess any statutory mortgageable, saleable and transferable rights in land and this security can be supplemented, if need be, by that of guarantors. Other reserve funds that they hold may be used as security. The Government guarantee of interest would enable the Provincial L. Mortgage Bank to float debentures and the distribution of credit can be made through central L. M. Banks to primary L. M. Banks and the services of the existing co-operative credit societies can be enrolled in the direction of, and supervising the application of, capital for productive purposes. A thorough and clean-cut division of the short-term and long-term loan is needed and the different kinds of the co-operative credit societies should be looking after this elaborate work and an efficient and sound division of labour would conduce towards the smooth functioning of these co-operative banks. As remarked already it is indeed

¹ See the Appendix to the Royal Agricultural Commission, Provincial Reports, Chapter on Co-operation—

Province.	L. M. Banks.
Assam	...
Bengal	...
Madras	...
The Punjab	...
	2
	1
	15
	11

For the defects of their working mechanism see the Annual Provincial Reports on the Co-operative movement.



difficult to float land mortgage banks in the case of tenants possessing no ownership in land. The cost of enquiries and the risk of bad business would be heavier in this case. But these should not deter the organisers in any way. Their need for relief is no less urgent and as the work of the short-term co-operative credit societies would be nullified by the existing weight of indebtedness it is essential to formulate a scheme to free the tenants from the existing loads and give him a fair chance to prosper. Mortgage banks are indispensable concomitants to the present-day agricultural conditions and would be valuable auxiliaries to the co-operative credit societies specialising in short-term credit. If the tenant is to be converted into a landowner, which is so essential so as to induce him to lock up capital for improving the land, land mortgage banks are essential.

(c) Recognising the cardinal fact that the land mortgage banks should be neither pure philanthropic institutions nor pure capitalistic mechanisms, it should be the endeavour of the people to create Provincial land mortgage banks with a reasonable amount of share capital. They should act as the apex bank for the smaller regional land mortgage banks operating within restricted areas, say, a group of five to ten villages, so that competent management may not be sacrificed. These banks should consist of land-owning borrowers or tenants. The former have to furnish land as security of the loan while the latter have to furnish other property, or reserve funds as the security. This security has to be properly valued by duly qualified appraisers and the loan is to run for a period of 15 to 20 years and the borrower has to repay it by easy half-yearly payments or clear off the debt all at once if he has the means to do so. The borrower has to pay a slightly higher rate than what the bank pays so as to provide for a small margin which can be spent for management expenses, reserve funds, valuation money and other necessary fees. Loans are to be limited to half the market value of the land. The loan is to form the first lien on the land or the collateral security, ranking first in priority to all other claims except the land revenue demand of the State in case of land-owning borrowers. The duty of the borrower is not to allow the land to depreciate in value and deteriorate in capacity. He has to systematically pay interest and the amortisation payment regularly till the end of the period.

(d) The Government management of the land mortgage banks started under the co-operative societies act should be vested in a separate department controlling the land mortgage banks which should be granted the following important privileges. The bonds floated by the land mortgage banks would command ready sale in the market only when the state guarantees the interest as was done in the case of the promotion of railways in this country. These can be included under trustee securities and the Charter of the Central Bank of Issue can make provision for these bonds being considered fit for the Central Bank to make its own investment.¹ Even the Insurance Companies on the look-out for long-term investments can safely lock up their funds in the purchase of these bonds. The State has to organise an efficient system of land transfer² and registration of title should be established. Special privileges about execution and foreclosure, exemption from stamp duty, registration fees, income-tax and provision for transfer of funds should be granted. Such special privileges are enjoyed by the land mortgage banks of other countries. State guidance and superintendence are needed.³

¹ So far as the 1873 Reserve Law of the Swedish Riksbank is concerned the Bonds of the Royal mortgage banks, Swedish Cities Mortgage Bank, and other domestic bonds quoted on foreign bourses can be held as part of the non-metallic reserve against which notes can be issued. See Spalding "Dictionary of Worlds' Currencies," p. 183. The author's suggestion does not amount to this but as the investments of the Central Bank these bonds should be considered fit.

² The Government has to maintain a register of the properties within its jurisdiction together with the names of the owners and particulars of the encumbrances in each case. On the faith of this register the Government can protect all purchasers or mortgagers against adverse claims. This is Registration of title. This is far superior to private investigation of title or the Insurance of title. Certificates have to be issued to the landowner and the vendor has to produce this to satisfy the purchaser or mortgager and give him authority to inspect the register. A new land certificate will be issued to the purchaser or mortgager after the completing of the sale on mortgage transaction. In Australia it was introduced by Sir Robert Torrens and the title is known as "Torrens Title." Registration of title to land exists in England, Germany and Austria-Hungary. See Encyclopaedia Britannica, article on Land Registration, Vol. 16, p. 165 (11th Edition).

³ The Baroda Committee postulates the necessity of too much State aid: "There should be Government purchase of Rs. 4 lacs worth of shares, Government under writing of 10 lakhs of rupees worth of debenture bonds, Government guarantee of interest and full value of bonds, Government assumption of the expenditure of management for the first five years, exemption of bonds from income-tax and stamp-duty and their registration as negotiable instruments." Undoubtedly there is too much of State spoon-feeding under this arrangement and the independence of the L. M. banks would be very shadowy.

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A provincial Board of Agricultural Advisers should be created to outline the general policy underlying these institutions. So long as the Board sees that the total amount of bonds floated by the Central Land mortgage bank is never greater than twenty times the paid-up capital and their reserve the business would be on a stable basis. It should co-operate with the Board of National Investment which has to look after the marketing of these bonds and create the investment habit on the part of the people. Without adequate financial help, control, fiscal and judicial privileges, propaganda and professional help from the other technical departments of the Government the land mortgage banks cannot succeed. Such has been the experience of other countries and would undoubtedly be the same if the Provincial Governments and the Government of India do not recognise the urgency of their development.

It is unwise to leave the agriculturist to the tender mercies of the sowcars so far as mortgage credit is concerned. It alone can eliminate the chances of conflict between the borrowers and the lenders of credit. The object of land mortgage banks is not only cheap credit but the elimination of such hostility. Collective guarantee with excellent security is the basis of their operations. Vigilance and control are their only proper safeguards. Land mortgage banks started on a limited liability basis and working on the above lines are essential for our agricultural prosperity and a slight change of sec. 4 of the Co-operative Societies Act of 1912 is needed.

Some people consider that co-operative land mortgage credit is a sordid and unpleasant task devoid of all moral and higher education and they deprecate all attempts towards the starting of such institutions. But sentiment should not be the guide in such a vital matter as this. Our agriculture needs considerable development so as to be able to furnish the needed food to our increasing population. Co-operative land mortgage is one important method which leads towards the perfection of agricultural long-term credit requirements.

This machinery for long-term credit must be conducted on right lines. The necessity of borrowing for production purposes instead of clearing off previous debts alone must be placed before the ~~borrowers~~. Secondly, the price paid by the agriculturist for this kind of credit must be lower than the average return of investment he can secure

from the agricultural enterprise. Thirdly, integrity, knowledge of and mortgage business, proper valuation of land by the appraisers, an efficient Provincial Board to issue bonds and a proper, thorough and adequate examination of the different land mortgage banks by this Board and the undertaking of proper preventive measures to be enforced on the land mortgage banks are essential for the success of the land mortgage banks. Fourthly, during days of agricultural depression the value of land would depreciate, the value of bonds may deteriorate or they may find no buyers at a fair price. But this would only be a temporary phase and the land mortgage banks must have wonderful strength to bear such a strain. Land values would generally be on a stable basis in this country. As population increases land values may advance in the near future and the land appraisers would have to be careful in the assessing of the market value of land. Everything depends on the Provincial Board and the land appraisers have to see to the proper working of the land mortgage banks and check them from making unwise loans. It is the duty of the agriculturist to improve his efficiency and inspire the investors with the belief that his land is a self-sustaining mortgage. The deposits that are taken by the land mortgage bank ought to form only a small portion of the total working capital and may be utilised for keeping up its engagements with the debenture holders if borrowers are lax in the matter of repayment. The "equated payment" system has to be adopted in matter of repayment by the borrowers. If other floating assets are also mortgaged to the bank there is no reason why they should fail as a result of default on the part of the borrower or any mistake in the valuation of land.

Of what avail would be the inauguration of a new policy of agricultural development if there is no credit machinery to enable the agriculturists to make use of them? Scientific researches and practical demonstrations of improved methods of farming are steps in the right direction. But they must also provide the needed credit for the agriculturist who is now in the throes of poverty. If any full advantage of the work of the Government agricultural department can be taken the land mortgage banks would have to use their influence in improving husbandry and devoting part of their reserve funds for experimental purposes. The greatest service the land mortgage banks



can render to the agriculturists consists in the lowering of the rate of interest to a low level and make possible the undertaking of several improvements on land.

Working hand in hand like the proverbial Siamese twins the co-operative land mortgage banks and the co-operative credit societies may be able to successfully tackle the problem of our agricultural indebtedness. Easily obtainable credit is not the sole panacea for the numerous ills of our agriculturists. Credit is an important factor and seasonal variations in prices can never be smothered out except by better credit and transport facilities. Solution should be sought in other directions to solve the complicated problem of our agricultural indebtedness¹ but these lie beyond the province of the banker.

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C. E. I—36.

„ —43.

„ —27.

„ —14.

„ —11.

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¹ As Sir Daniel Hamilton says, "the Indian ryot carries a mountain of debt on one shoulder and a mountain of illiteracy on the other shoulder." One way of benefiting him is to educate him and teach him the powers of organisation and he would be able to solve his indebtedness question. Other remedies like improved methods of agriculture and development of subsidiary industries may also help him. See my monograph on the "Future of our Agricultural Industry," Welfare, published from May, 1926 to June, 1927.

CHAPTER XI

THE INDIAN POST OFFICE SAVINGS BANKS.

The rise of the P. O. Savings Banks—Their object—Their limited progress—Their banking services—Suggestions for increasing their utility—Comparison with England—Appointment of a committee to discuss the feasibility of a few suggestions—Statistical Tables showing the growth of the P. O. Savings Banks.

The existing system was a gradual development out of the Government Savings Banks which were started in the Presidency Towns between 1833-1835.¹ Their management was transferred to the Presidency Banks between 1863 and 1865. In 1870 their system was extended to certain selected districts where they were instituted in connection with the district treasuries. A uniform type of these savings banks was introduced in all other parts of the country in 1882. These absorbed the business of the district savings banks in 1886 and that of the Presidency Banks in 1896.² From that date forward the Savings Banks have been managed by the Postal Department. All accounts are treated as at call as in ordinary banking. No special reserve is maintained against these deposits. The deposit money constitutes what is known as "unfunded debt"³ and is a floating charge on the credit of the Government. The deposit money

¹ While the classification of the public debt into unproductive and productive debt is well-understood by the people the difference between the funded and unfunded debt is not thoroughly grasped. Funded debt refers to the obligations of the Government which can be repaid after a certain number of years or to those items which do not carry the obligation to repay the principal. Unfunded debt means the obligations of the Government which are to be repaid within a year of the time it is incurred. It is also usually known as the floating debt. The following table shows the growth of unfunded debt under this heading alone : (In lakhs of Rs.)

Year	...	...	...	1921-22	1922-23	1923-24	1924-25
P. O. Savings Bank deposits	...	...	...	2,226	2,320	2,498	2,563
P. O. Cash Certificates	...	...	...	434	312	841	1,311

² See the fifth Decennial Report of Moral and Material Progress in India, p. 302. See also G. Clarke, *The Post Office of India and its Story*, p. 81.

³ See the earlier chapter of this Book, "Organised Banking in the Days of the John Company."



is utilised for capital expenditure. The savings of the poor are used for purposes remote from the benefit of the depositors. It also leads to the placing of "all eggs in the same basket." Although there might be a sudden run on those P. O. Savings Banks the Government can meet it without any great difficulty.¹ The adoption of the remedy which the French P. O. Savings Banks adopt during such period is the insisting of 15 days' notice for all deposits above 50 Francs, and this would be of signal use and would tend to check any depreciation of Government credit at such times.

Object.

The chief object with which they were started was to inculcate the habit of thrift among the working people and the middle and lower sections of the community. Good social and domestic results would be reaped if the number of provident people having safe bank deposits, were to be the rule instead of the rare exception as at present. Direct encouragement to investment is given by the granting of interest which is 3 per cent. on call deposits. The limit up to which an individual depositor can place money is Rs. 750 within the course of an official year. The individual amount of deposit cannot be more than Rupees five thousand. The Government gives the depositor the option of converting his money into government paper if he so likes.

Nearly seventy-five per cent. of the depositors belong to the professional classes and the intelligent middle class people avail themselves of these Savings Banks and it is only very few of the agriculturists that make use of these Banks. Their ignorance and illiteracy stand in the way and the present low rate of interest is not sufficient inducement to compel them to retain their savings here. Mortgage and pawnbroking business pays more and even the ladies of wealthy families and successful lawyers utilise their savings in this lucrative money-lending business. So long as mortgage banks specialising in this particular line are not started the investment of savings in

¹ There were four such runs made on the P. O. Savings Banks. During the Russian Scare of 1885, the famine days of 1896, the boycott and Swadeshi agitation days of 1907 and in 1914 when the German Government confiscated the Savings Bank deposits in that country there were sudden runs on the P. O. Savings Banks.

these banks or the Indian joint-stock banks cannot be expected to increase. The possession of land confers peculiar social status and much money is consequently invested in the land mortgage business. So long as these habits dominate it is hard to expect any increase in the banking habit of the people.

Their limited Progress.

Sir H. B. Smith's Committee writes, "we are impressed by the comparatively insignificant figure of the total deposits in the Post-Office Savings Banks amounting to only Rs. 24½ crores on 31st July, 1914, before the conditions that ensued on the outbreak of the war led to the heavy withdrawals. We understand that the substantial increase in deposits in the years 1912-13 and 1913-14 amounting to over four crores, was due mainly to the grant of additional facilities and we recommend that the Government of India should examine how far, notwithstanding the admitted administrative difficulties, it may be possible to improve the present procedure for the deposits and withdrawal of money and to increase the number of post offices conducting savings bank business."¹

Their Banknig Services.

The banker's interest in the matter of the P. O. Savings Banks does not confine itself only to their deposit-attracting function. These banks undertake internal remittance work, *i.e.*, facilitate the transfer of small sums of money from place to place by the money-order system.² The Government follows the well-known clearing principle in the matter of this business. It sets off payments in opposite direction against one another and thus obviates the necessity of sending coins or currency notes. As a matter of practice it has realised

¹ Vide Sir H. B. Smith Committee's Report, p. 32.

² Before the inauguration of the money order system in 1880 the Government Treasuries issued bills of exchange current for 12 months upon one another and as there were only 200 offices of issue and payment it could not satisfy the requirement in any way. Currency notes were consequently sent by post as a safe and cheap method of remittance. See Geoffrey Clarke, "The Post Office of India and its Story," Chapter VII.



that amounts remitted to and from a town very often balance one another during the course of the week.¹

The Government P. O. Savings Banks also provide for telegraphic money order facilities, Rupees 600 being the maximum limit up to which they can be issued. These T. M. O.'s must not include a fraction of a rupee. The ordinary fee *plus* a telegraphic fee is charged. The practice of remitting money-order commission fees when land revenue is paid has to be further encouraged.

The Post Office provides facilities for making remittances abroad. The Postal order transactions between India and foreign countries are too well known to need any detailed description and analysis here. Funds are remitted from Mesopotamia, Persia and Ceylon through the Post Office and the import of funds annually through the Post Office has to be noticed.

The Post Office Savings Banks are literally the bankers of the poor and even investment in Government stock is facilitated to a certain extent. As the "democratising" of public credit would be the chief advantage of a wide-spread extension of this habit every encouragement should be afforded in this direction. Public credit can become easily stable and the Government loan policy would always succeed if only these depositors become more familiar with Government stock.

Sometime back even bullion shipments to and from India were undertaken on behalf of the Anglo-Eastern Banks by the parcel post. By this means a parcel of five hundred sovereigns was sent at a very small cost of 6s. 5d. and the Shipping companies finding the extended use of the parcel post being resorted to for this business protested against this use. The Government declared it illegal and a notification was soon issued prohibiting the transmission of more than £5 of gold in any one cover.²

Sir Edward Brabrook styled the Savings Bank deposits as "infantile efforts in thrift" and it is well-known that people who have

¹ The present fee for sending ordinary money orders is graduated as follows : on any sum not exceeding Rs. 10 the fee is annas two, on sums exceeding Rs. 10 but not Rs. 25 the charge is annas four, on sums of Rs. 25 if the remainder is less than Rs. 10 the charge is annas 2 but if it exceeds Rs. 10 the charge is annas four.

² I. Hamilton, "An Outline of Postal History and Practice," p. 32.

been broken to thrifty habits pass on to other agencies for investing their money. The progressive stages in the development of thrift might be denoted firstly by the money-box, secondly the savings-bank deposit, thirdly the ordinary commercial bank and finally wider investments. This steady growth of savings depends on the fact that people have confidence in the savings banks and that opportunities exist in large number for investment in these banks.

Suggestions.

Unfortunately in this country we have only the savings departments of the commercial banks, the Imperial Bank of India and the Postal Savings Bank to handle the savings of the people. In other countries the savings departments of the Trust Companies, building and loan associations and municipal savings banks compete with one another for this business. So far as the United Kingdom is concerned there are three great national agencies in addition to the Joint-Stock Banks, Building and Co-operative Societies and Investment Trusts, Penny Banks, School-Savings Banks and thrift-clubs and Railway Savings Banks. While the big investing classes are the clients of these institutions the small investing classes are encouraged to invest their savings in the Trustee Savings Banks, the P.O. Savings Banks and the National Savings organisations. The Trustee Savings Banks, now numbering 131 with numerous branches and sub-offices numbering 437, are located in thickly populated areas. They date back to the beginning of the nineteenth century. They were started by individuals actuated by purely altruistic motives and from 1891 a statutory inspection of the working of these T. S. Banks was organised by the State. Numerous acts were passed since that year, the latest was in 1920. The savings were invested through the National Debt Commissioners. The deposits of the poorer classes were paid $2\frac{1}{2}$ per cent. rate of interest and the T. S. Banks were allowed to obtain £2 12s. 6d., the additional sum being intended solely to cover the costs of management. The larger

¹ France pioneered the way in this direction and in almost all the European countries the School Savings Banks exist. These aid rather than retard private banking enterprise for the initial training would promote, develop, foster and implant habits of thrift and industry.

T. S. Banks have their own Investment Department and require one month's notice from the depositor to withdraw his deposit. Three and a half per cent. is allowed to the depositor and the National Debt Commissioners have to sanction the investments made by the T. S. Banks. They also undertake to carry out individual investments in certain classes of Government stocks specified by statute. The holders of the investments receive all the benefits of this investment. The following figures speak eloquently of the progress of the investment habit.¹

Ordinary Depositors.

	Year. 1915			Year. 1924
No. of Ordinary depositors.	1,966,730	...	...	2,295,535
Amount of deposits	£51,412,370	...	...	£82,285,044

Special Investment Deposits.

No. of depositors	107,564	...	...	120,604
Amount of deposits	£15,377,281	...	...	£24,753,347

Individual Stock Investments.

No. of Investors	90,017	...	...	256,871
Amount of Stock or Bonds held.	£6,377,391	...	...	£30,928,947

Another noticeable feature of the Post Office Savings Banks of the United Kingdom is the facility granted to the Penny Banks that are affiliated to it. There are 4,500 Penny Banks and the depositors are children in the small schools of the country. These secure ledgers, cash books, etc., free of cost from the Post Office as soon as these are affiliated to it.

The National Savings Organisation was started in 1916 as recommended by the Parliamentary Committee on War Loans for the small investors. The War Savings Certificate which can be secured by paying 15s. 6d. is payable at the end of five years in £1 and this income is exempt from income-tax. These are however sold only to

¹ For more detailed information and recent figures, see the Report of the Bradbury Committee on Municipal Savings Banks, cmd.—3014 (1928), pp. 17-21.

those whose income is below £300 a year and this maximum has been recently raised to £500 a year and in 1923 the price of the N. S. Certificate was raised to 16s. and at the end of five years it is payable in £1. Twenty thousand Savings Associations have been created and a large army of voluntary workers are affiliated to the Committee.

As such multitudinous nation-wide agencies do not exist in this country the P.O. Savings Banks should be made more popular by granting more concessions as to the withdrawal of money, say twice a week, with an interval of four days between successive withdrawals, the raising of the maximum amount of deposit money from Rs. 750 to Rs. 1,500 and the issuing of more pass-books in vernacular to those who desire them are some of the means of popularising these P.O. Savings Banks. The present rate of interest was fixed long ago when the Government borrowed at three and half per cent. The Government should realise that the value of money has gone up enormously. The Government is at present borrowing at five to five and half per cent. The Post Office cash certificates which are issued at a liberal rate of interest running practically at compound interest are detracting the popularity of the Savings Banks. It is indeed bad statesmanship to pay $3\frac{1}{2}$ per cent. to the poor and middle class depositors while it pays four and a half or five per cent. to the richer people who lend money to it. Profiteering out of the low interest of the small investor is the most undesirable source of revenue. This is the chief reason why deposits in the Indian P.O. Savings Banks have not increased along with or kept pace with the deposits of other Banks. The Post Office clerks can be deputed to attend workshops and factories on pay-days and secure deposits from the wage-earners.

Every sub-treasury of the Government should be utilised as a Savings Bank and even co-operative societies can be permitted to open a current account with them. The Savings Bank system should be pushed energetically throughout the country by opening more Post Offices. They number at present roughly 20,000 but all of them do not conduct savings bank business.

The deposit money should be utilised for the local needs of the district¹. It should not be utilised as a support for the exchange

¹ This is what is done in the U.S.A. The national and the State Banks obtain the deposits secured through the Postal Savings Banks system. The banks pay about $2\frac{1}{4}$ per

situation or remitted to London for use there by the Secretary of State for India or used for meeting Council Bills or purchasing sterling in India. This centring in the Government Treasury chest and draining away money from beneficial uses from the provinces is an unpardonable mistake.

The Government of India is making an organised effort to increase public interest in the sale of the Post Office cash certificate which has often been designated as the "interest-bearing currency note." These were first issued in 1917 with the object of encouraging the investment habit on the part of the smaller investors and about eight crores of rupees were invested in this way by the end of March, 1919. With the introduction of improved rates of interest and addition of further attractions the popularity of this form of investment increased to a great extent and in the official year ending in March 1924, about Rs. 5.3 crores (net) were realised. In 1924-25 the net amount realised was about Rs. 4.6 crores.¹ With greater propaganda work on the part of the Government it is possible to obtain greater sums which should not however be utilised to satisfy the capital

cent. for such deposits and 65 per cent. of the P. O. Savings Bank's deposits are loaned out to the Banks in the State or Territory in which they have been obtained. The P.O. Savings Bank's deposits are thus made to help the credit resources of the country. It is essential that this example has to be followed and if a portion of the deposits can be loaned out to the Co-operative Banks of the district which are requiring greater resources, more profitable use of these deposits can be made. "Even in Belgium, France, Italy and Germany the deposits are used for municipal loans, agricultural credit and the creation of workmen's dwellings and any other safe public investment. Thus the *object everywhere else is to aid local industry and the deposit is being used for increasing wealth.*" See I. Hamilton, "An Outline of Postal History and Practice," p. 56. (*Italics mine.*)

¹ It is indeed an anomaly to note that although our public debt has risen nearly to 1,000 crores of rupees no provision has been made for the creation of a Sinking Fund to wipe off gradually the unproductive debt and maintain the credit position of the Government intact both at home and abroad. The scheme of a real Sinking Fund should not be held over for a further period. Proper provision for a Sinking Fund out of the current revenues is the only financial expedient that can maintain the credit of a Government intact and to postpone it indefinitely on the plea that the relief to the tax-payer is more important at the present stage is the height of financial folly and ignorance. A perpetual, anxious and increasing effort to reduce the public debt should be made by the next finance minister. The institution of a Provincial Loans Fund for procuring necessary funds to the Provincial governments and the charging of a standard scale of interest for ~~productive~~ and unproductive debt are improvements in the public debt situation. The institution of a Depreciation Fund for the 5% 1929-47 and 1945-55 rupee loans is another desirable step in the improvement of the public debt.

requirements of the Government. A portion of the money obtained by the sale of these P.O. cash certificates in the district and rural areas should be set aside for use in those rural areas thus increasing the rural credit resources and help the building up of rural prosperity. The sale of the P.O. cash certificates is ultimately bound to give great stimulus to thrift and the systematic encouragement of this habit will have profound influence in bettering the future economic condition of the people. The sale of the cash certificates through village accountants and accepting them in lieu of cash as payment for land revenue would still further increase their popularity. Although further attempts in this direction of increasing their popularity can be made proper funding arrangements are long overdue and no time should be lost in making provision for this unfunded debt. No further reduction of interest yield as was brought about in April, 1926 and 1927, should be made for the P.O. cash certificate is the only popular form of investment available to the poorer classes. They are now sold in the denominations of Rs. 10, Rs. 20, Rs. 100 and Rs. 500 and if the investor holds the certificate till maturity the interest ranges to $5\frac{1}{2}$ per cent., free of tax. In July, 1927, this rate was still further reduced to $4\frac{1}{2}$ per cent., free of tax. But this reduction is responsible for decrease in the net receipts.¹ See Table II at the end of this chapter.

A small Committee should be appointed to consider the desirability of introducing the progressive model of the postal system of the countries like Austria-Hungary or the Swiss Republic. The development of the postal cheque² and its possibilities should be explored.

¹ Since these lines have been written the Government has once more raised the interest on P.O. cash certificate and undoubtedly the depositors will not fail to avail themselves of the concession.

² Quite recently a Committee of the Post Office Advisory Council presided over by Sir G. Lawson-Johnston considered the advisability of introducing the Postal cheque system in the United Kingdom. The report does not advocate the introduction of the Postal cheque system but in order to encourage wider expansion of banking habits and secure economy of currency the offering of cheque facilities for the P.O. Savings Bank depositor was recommended. It however recognises that there is considerable danger in allowing the depositor the use of cheque book. The placing of a maximum limit on the amount of the cheques that could be drawn and to issue such cheques only when balances are sufficient to cover the maximum amount drawable are certain safeguards that have been recommended. (See the London Times of August 2, 1928, p. 133.)

The Government should open postal cheque offices and permit individuals after proper introduction to open an account at these offices with a permanent fixed deposit of Rs. 100. This can be operated through any Post Office in the country and money transmitted to any other part of the country without limit of amount. Of course a moderate charge can be levied in this case as in that of the money-order system. In a big country like India where banking is so imperfectly developed, a system of this kind will make money fluid and, as Mr. Darling suggests, this would be of the greatest advantage to co-operative societies to whom the transfer of money is often a matter of considerable difficulty.¹

Instead of developing this progressive arrangement of the postal cheque¹ the Post Office has after all devised only the use of cheques in payment of money orders in Calcutta, Bombay, Madras and other bigger commercial cities of this country. Firms or individuals who are to receive a large number of money-orders daily and are wishing to receive payment by cheque, are usually paid by means of a cheque by the paying post office. The acknowledgment forms of the money-orders as well as the receipt of the cheque have to be signed by the payees. Finding it cumbersome specially in the case of mistakes, the new procedure of handing over the cheque is done after the list is given to the payee and adequate time for examining the list is also afforded to the payee.

The introduction of some other desirable features must be examined by the above Committee. The Indian Post Office Savings Banks must undertake to collect cheques on behalf of depositors and they may be subject to withdrawal after the period of a week so that the P. O. would have reasonable time to collect the proceeds of the cheque. The introduction of small Home safes and the permission to open "joint accounts payable to either or to the survivor" would increase the available deposits that it can gather from the hands of the small savers. As in England the Savings Banks' deposits of a judgment debtor should not be made liable to attachment by the creditor. Indian depositors can also be given the privilege of nominating the beneficiary to which the deposit sum can be paid on the death of the

¹ See M. L. Darling, "Co-operation in Italy and Germany."

See Statistical Abstract for British India, 4th Issue, p. 556.

depositor.¹ This would render unnecessary the duty of investigating the rightful claimant, and the surviving heir would easily secure the deposit sum with the minimum possible delay. Unless such rigorous steps are taken to popularise the P. O. Savings Bank it is quite likely to become a moribund affair as compared, for example with the German Savings Banks.

Table I, showing the growth of Deposits in the P. O. Savings Banks.

Year.	No. of depositors.	Deposits (each year) inclusive of interest in lakhs of Rs.	Interest.	No. of Post-Office Savings Banks.	Withdrawals each year.	Balance of deposits (inclusive of interest)
		Rs.	Rs.	Rs.	Rs.	Rs.
1915-16	1,660	816	43	10,386	773	1,532
1916-17	1,647	938	45	10,421	810	1,659
1917-18	1,637	1,016	44	10,975	1,017	1,658
1918-19	1,677	1,345	46	10,587	1,121	1,882
1919-20	1,760	1,774	56	10,670	1,522	2,134
1920-21	1,877	1,884	62	10,713	1,733	2,286
1921-22	1,958	1,772	61	10,758	1,832	2,226
1922-23	2,043	1,769	62	10,730	1,675	2,319
1923-24	2,089	1,838	67	10,535	1,679	2,478
1924-25	2,164	1,850	71	10,727	1,764	2,563

Table II, showing the Transactions on account of the P. O. Cash Certificates (in lakhs of Rs.).

Year.	Receipts.	Repayments (Net).	Receipts.	Outstanding at the end of the year.
	Rs.	Rs.	Rs.	Rs.
1917-18	1000	112	888	888
1918-19 and 1919-20	403	716	—313	575
1920-21 and 1921-22	100	241	—141	435
1922-23 and 1923-24	761	353	408	842
1924-25	610	140	470	1,312
1925-26	955	170	785	2,097
1926-27	753	172	571	2,608
1927-28	609	206	403	3,021

¹ See the Report of the Controller of Currency for the year 1927-28, p. 22.

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CHAPTER XII

THE CO-OPERATIVE BANKS.

The chief object of the chapter—Co-operative Banking in India, its origin—General features of the co-operative credit movement—The progress of the C. C. movement—The structure of the C. C. societies—The present problems—How to secure improvement?—Co-operate with the I. C. Organisation—The C. Bank *vs.* the Jt.-St. Bank—*Complementary institution*—Economic benefits of the C. banking—Non-economic benefits—Slow and steady wins the race—Extension of co-operative activity in other directions than credit.

The Co-operative Bank.

The chief object of the chapter is to show the structural difference between a co-operative bank and a commercial bank and the different methods of procedure adopted by them. As the report of the Government Committee on Co-operation in India shows, "the same basic laws of finance govern both ordinary and co-operative banking."¹ The co-operative bank is only a miniature bank which deals with the smallest unit of saving and equally small questions of credit.

The Origin of the Co-operative Credit Movement.

Co-operative banking in India is in its infancy. Sir Henry Stork first conceived the idea of starting the co-operative movement in India. This was no doubt due to the initiative which other countries were showing in this matter. Leon D'Andriment in Belgium, Leone Wollenberge in Italy and Prof. Tanviray of France were the pioneers of this movement in their native countries but little headway could be made in this country against popular apathy. Sir Frederick Nicholson was commissioned in 1892 to study the agricultural banking organisation of other countries and recommend one suitable type to alleviate the sufferings of the Madras agriculturists. H. Dupernex was doing spade work in the matter of the peoples' banks in

¹ MacLagan Committee's Report on Co-operation in India, 1915, pp. 65-70.

the United Provinces.¹ It was Lord Curzon who was really anxious to increase the wellbeing of the people that appointed a committee to consider the feasibility of introducing the Raifessin system of co-operative organisation. The Famine Commission of 1901 urged the importance of starting mutual credit associations. The Co-operative Credit Societies Act was passed in 1904 "to encourage thrift, self-help and co-operation among agriculturists, artisans and persons of limited means." But there was no provision made in this Act to create central societies for supervising and financing the primary rural and urban societies and legal protection was not extended to co-operative societies organised for other purposes than credit. The remodelling of the Act in 1912 gave scope to remedy the above defects observed in the course of its working during the half dozen years. The Co-operative Societies Act of 1912 conferred legal status on co-operative societies organised for marketing, production and insurance. Scope was given for creating central organisations. The old-fashioned distinction between rural and urban was given up and the present classification of limited and unlimited liability was introduced in its place.

General Features of the Movement.

To-day there are a great variety of types among the credit societies. The money doles extended by the Government in the early stages of these societies have been discontinued. In the matter of audit, supervision, training and propaganda non-official support is being actively enlisted. But as it is, the present co-operative movement has not been sufficiently de-officialised. The Registrar and the staff of the Co-operative Department constitute the administrative side of the movement and perform the inspection business. The Provincial co-operative banks and the District Banks constitute the financing machinery of the primary co-operative societies or

¹ See Mr. H. Dupernex, "Village Banks," pp. 8-11. For an account of the defects of these societies, see the Agricultural Journal of India, 1906, Article by V. H. Simpson, I.C.S.



units. The Provincial and District Federations of non-official men, the unions and institutes form the propaganda body and co-operative education is diffused through these channels. Supervision and propaganda constitute their regular business. The progress of the co-operative movement depends on the proper functioning of these three distinct organisations.

The Progress of the Movement.

More societies are arising. Members are increasing. The capital of the societies is fast increasing and though a crisis in one province or a failure in other places may occur the movement is having a healthy growth and real progress is being achieved in several directions. The following table gives the reader an idea of the gradual growth of the co-operative societies.

THE CO-OPERATIVE BANKS

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Year.	No. of societies.	No. of members.	Total working capital.	Paid-up share capital (Rs. 1,000 omitted.)	Loans and deposits from members.	Loans and deposits from societies.	Loans and deposits from Provincial and Central Banks.	Loans and deposits from Government.	Loans and deposits from non-members and other sources.	Reserve and other funds.
Average— 1906-07 to 1909-10	1	161,910	Rs. 6,812	Rs. 1,319	Rs. 1,412	Rs. 1,359	Rs. ...	Rs. 586	Rs. 1,962	Rs. 167
Average— 1910-11 to 1914-15	11786	548,253	54,842	8,877	8,828	19,342	...	1,067	14,198	2,500
Average— 1915-16 to 1919-20	28477	112,891	1,51,847	25,197	9,635	4,781	50,319	2,528	47,025	12,332
Average— 1920-21 to 1924-25	57707	2,154,007	3,63,626	52,566	25,445	14,998	1,22,988	6,769	1,09,622	31,838
1925-26	80182	3,058,025	5,76,039	78,065	38,861	20,218	1,92,190	13,804	1,81,600	51,301
1926-27	89071	3,421,905	6,79,361	88,738	44,952	23,699	7,28,376	15,101	2,18,442	60,053

Capital is increasing faster than membership, being now nearly Rs. 199 per member and the average membership per society is now 39. The capital is Rs. 7,628 per society.

Co-operative Movement in India, 1926-27.

While the above table speaks of the growth of the co-operative societies of all kinds the following table shows that there is progress in the growth of non-agricultural societies, the Central Banks and the guaranteeing unions as well :—

	Average ending from 1915-16 to 1919-20.	Average ending from 1919-20 to 1920-1925.	1925-26.	1926-27.
1. Central (including Provincial Central Bank and banking unions.	404	508	567	577
2. Supervising and guaranteeing unions.	638	1302	1406	1421
3. Agricultural (including cattle and insurance societies).	25873	5116	71140	78940
4. Non-agricultural.	1662	4133	7069	8133

The co-operative credit movement is clearly making rapid financial progress. The financial resources of the co-operative credit societies are becoming stronger than before. There is a steady increase of the working capital of the banks. Unlimited liability with share capital has proved a distinct success. Although loans from the central banks bulk largely in the matter of agricultural societies deposits from members are slowly increasing. The Reserve Fund is increasing and a judicious use of it is being made. Loans to members for directly productive and unproductive purpose¹ are granted at rates of interest ranging from 9% to 15% and the repayment of these loans by means of instalments has proved a benefit to the borrowers. If the membership of the agricultural societies is taken into account they belong to all classes of society. Landholders, tenants and labourers are generally members of these societies. The Post Offices in which the funds of the co-operative credit societies are deposited have devised improved means to liberate these funds as quickly as they are required by the societies. Sometimes well-to-do members to

¹ This is best defined by the MacLagan Committee itself, "Unproductive loans are for inevitable expenditure and not excessive in amount." The contracting of such loans is the weak spot in the agricultural economy of the Indian peasant.



whom is entrusted the fund have been won over to the cause of the co-operative movement. Thus a safe solution has been devised for the safe custody of the funds of the primary co-operative society. The local management of the co-operative credit society usually rests in the hands of the punchayet or managing committee consisting of elected officials working gratuitously and the business consists in looking after applications for loans, settling problems of admission and expulsion of members, receiving deposits, collecting overdue loans, checking accounts and allotting money for the working expenses of the society.

These individual and completely independent village societies as they are styled in co-operative literature are federated into unions or central societies for securing finance and proper control. Unions formed solely for continuous supervision purposes are simply designated unions or supervising¹ and audit unions. The function of guaranteeing unions is to supervise and guarantee the security of the societies affiliated to it.² They maintain a rotation register, revise property statements, and keep a register of delegates of primary societies. The governing body of the union has to inspect the financial position of the societies and recommend loans to be made by the Central or District Bank. Just as the financial side of the co-operative hierarchy is organised on a proper basis so also for the educational and propaganda business there is a well-knit organisation of which the supervising or guaranteeing union forms the primary unit. The guaranteeing union consists usually of twenty to thirty societies or more. They are organised into federations and these have their apex organisation in the Provincial co-operative union. The duty of this federation is to formulate a right educational policy and see that the Unions carry it out in right earnest. They are the real agencies which are to introduce supervision, propaganda, and education and help the position of the financing banks to a great extent by enabling the people to understand the true spirit of the co-operative movement. If the

¹ In Bombay they are very popular and help the Central Banks in their financing operations.

² The Province of Burma was the first to create this type of organisation. The MacLagan Committee recommended its adoption by other Provinces but they have not been adopted by other Provinces except the Central Provinces.



function of procuring finance is also attached to the other duties of the union it is styled the Banking Union. But if a central society exists purely for securing finance for the constituent members it is designated a Central Bank.

The Central Bank of the mixed type ¹ where individuals as well as primary co-operative societies can become members, has been accepted as a suitable form of organisation and unlike the European Central Banks which act as mechanisms for balancing funds the primary duty of the Indian counterpart is to secure more funds to the individual co-operative banks. In addition to this the inspection of affiliated societies is also taken up by the supervisors appointed for this purpose so that they can check the decline and fall of primary societies which have borrowed from it. This administrative action of the Central Banks is bound to be useful to the movement, for it enables the Central Banks to occasionally inspect the financial position of the primary societies and instead of placing reliance only on their unlimited liability feature they can better gauge their ability and prevent them from drifting into chaos. This becomes inevitable when the supervising unions and the federations do not discharge their work of supervision on correct lines.

Superimposed on the different Central Banks is the properly constituted apex Provincial Bank ² and its recognised duties are to lend through the Central Banks and invest the surplus funds of the Central Bank and deal with the primary village societies through the Central Banks alone. It also acts as the channel of inter-communication between the co-operative movement and the Imperial and the joint-stock Banks.³ "Its sole business is to forecast and arrange for the

¹ The main reason why pure type banks consisting solely of the primary societies cannot be recommended is that adequate talents cannot be enrolled for managing the primary societies and the neglect of support which enthusiastic non-official people are willing to render would be a sheer unpardonable mistake. The danger is that they might become pure monetary banks without the expert guidance of bankers.

² The Bombay Provincial Co-operative Bank has started a net-work of branches in the province to conduct its financial operations. It is feared that such a step would make it too commercial in character and that the truly co-operative character of the organisation would be forgotten. So long as the right to grant loans is not observed the borrowed money is not pressed in non-productive directions it is unwise to level the charge of commercialisation against it.

³ See the Report of the MacLagan Committee on Co-operation, p. 59.



provincial requirements as a whole and be the financial co-operative centre for the province," says the MacLagan Report.

A bird's-eye-view of the co-operative financial structure has been given and it would not be complete if the relations between the Provincial Banks and the money market are not outlined. It has clearly been stated that the cash credit system of lending to the apex Provincial Bank is approved by the Imperial Bank of India. Other joint-stock banks also lend on the cash credit basis or grant loans for a specific period to the District Central Banks.

The Present Problems.

Initially organised by the State the co-operative idea has received a wide extension and the present problem is the gradual diverting of the duty of the State in matters of organisation, management and supervision and handing them over to the popular control of federations of the co-operative societies without endangering their stability, minimising their popularity, undermining popular confidence and reducing the efficiency of the co-operative societies. A gradual transference of duties of organisation, and supervision to local unions and honorary workers possessing the requisite knowledge, enthusiasm, time and driving power must be accepted as the only available solution. At present an absolute demarcation of work between the official Department of co-operation and the honorary non-official apex co-operative organisations is essential and as the work of the latter bodies proceeds on a satisfactory basis more functions should be entrusted to them. It is these non-official organisations that ought to initiate and organise co-operative work in all directions and the future role of the Registrar should dwindle to that of a mere expert adviser acting as a guide, philosopher and friend. Periodical Government audit should continue and the primary societies should continue to pay for the annual audit. The other Government Departments such as the Agricultural and the Industrial should co-operate with the Co-operative Department. The granting of free technical advice to non-credit societies should continue.

While the broad principles of the co-operative structure have been stated it may without exaggeration be said that it has not evolved a

systematic and definite policy of its own. The co-operative mind is still oscillating between the long-term and short-term loans.¹ Except in Burma where the problem has been tackled successfully² and a brand new co-operative organisation for the granting of long-term credit by National Mortgage Societies is shortly to be created (March 31, 1928), the other provinces are still striving to combine limited long-term³ loaning business with short-term loaning business. The problem of securing adequate financial help in those provinces where the co-operative credit system has not obtained enough working capital has not been satisfactorily solved as yet.⁴ Some of the Provinces have not created the Provincial Co-operative Apex Bank as yet.⁵ It is only quite recently that the apex co-operative Bank of Bangalore was started as the central financing agency of the co-operative movement in the state of Mysore. The problem of obtaining access to the money market to permit the provincial banks to unload their seasonal surplus or to borrow funds by rediscounting their paper has yet to be solved.

The system of securing cash credits and overdrafts from the hands of the Imperial Bank or the other joint-stock banks is only a useful palliative. The starting of an All-India Co-operative Bank would be unnecessary in the light of new developments that have taken place during the last decade and progress in no province should be hindered for the sake of dull uniformity and for allowing the backward provinces time to level themselves up to the position of the more forward provinces. The holding of joint-conferences annually and co-ordinating the

¹ The Agricultural Commission has done signal service in recommending a complete separation between the two lines of credit. See p. 460.

² See the Burma National Co-operative Mortgage Bill for instituting long-term credit facilities for the present proprietors.

³ The Naogaon Ganja Mahal Co-operative Bank, Ltd., which is the only mortgage Bank in Bengal, conducts both short-term as well as long-term business. In Bombay the attempt is to institute a separate development for looking after long-term credit needs and that the Provincial Co-operative Bank should take up the financing of land mortgage Banks operating in the smaller areas.

⁴ See the Oakden Committee Report on Co-operation in the United Provinces. No apex Provincial Bank is recommended on the supposed assumption that a glut of capital would ensue in the slack season.

⁵ Deposits from only 10 to 15% of the working capital of the Indian Co-operative Credit Societies. In other countries the proportion is decidedly higher often running up to 80% of the total working capital.



efforts of officials and non-officials, the formation of an All-India Co-operative Union to improve the co-operative backwardness of India by consolidation and the federation of the existing co-operative societies, the subject of co-operative education, the important issue of the future attitude of the Government towards the co-operative movement, the problem of relieving the over-burdened registrars, the training of the co-operative personnel in the law and principles of co-operation and the evolving of the proper business methods on sound financial lines have not been satisfactorily dealt with and an effective solution of these problems would improve the organisation, increase the momentum of the co-operative movement in India and will bring India into line with other progressive countries of the co-operative world.

How to improve the C. C. Societies.

But the realisation of the above programme depends on the improved working of each financial unit of the co-operative system, *viz.*, the village society. The primary village co-operative society must pay more attention towards attracting voluntary deposits and the consolidation of the village banks as these form the very foundation of the co-operative system. The method of attracting and encouraging voluntary deposits from members adopted in Japan can be copied wholesale in our country.¹ The officials and employees of the co-operative credit society visit each house and collect deposits. "Members take it in turn to collect. Collecting boxes are provided by the society. Savings clubs are organised and on the savings days deposits are taken simultaneously by the members. A part of the proceeds of the sales of property is deposited as a compulsory thing. To encourage deposits societies may grant high rates of interest on greater deposits or money rewards. The pass-book is granted to families to save in favour of children. A portion of the harvest is collected and converted into deposits. Encouragement of subsidiary industries as bee-keeping, breeding silk-worms, etc., has also been given. All dividends are converted into deposits. Lectures on thrift are delivered and thrift songs specially

¹ See Kiyoshi Ogata, "Co-operation in Japan," p. 133.

composed in a popular style are sung by members." Unless the working capital increases the general shortage of money would be felt and it would be difficult to cope with demand from the different societies. But when we take the characteristics of the Indian agriculturists into account it becomes easily apparent that the matter of gathering deposits is not an easy task. The ryot distrusts banking and the maintenance of bank account presupposes the existence of capital. His only object is to invest his all on land. He does not even shrink from borrowing to purchase land. Land and real estate form his desirable assets and he prefers to borrow on this security. A banking population on the other hand would draw a cheque on its balance. So long as this psychology exists unchanged it is difficult to create the banking habit in the minds of the ryot.

The practice of receiving interest alone regularly on the loan instead of insisting on the repayment of the full loan has to be checked. Short-term loans must not be allowed to become long-term loans in practice for long-term loans generally become arrears. The granting of loans to men comfortably situated in life so that it might be advanced in small sums to others at high rates of interest is the reverse of co-operation and has to be discountenanced. Proper steps must be immediately taken without fail to collect loans if they are misapplied by borrowers. Regular holding of monthly meetings, prompt entry of all transactions in the records, the maintenance of fluid reserve in case deposit banking is pursued and repayment of loans in due time must be secured and encouraged. All the transactions must be conducted on well-known business principles. The borrowing capacity of these primary societies must not be exceeded. Money should be granted to borrowers on standing crops up to 50% and harvested crops up to 80 per cent. and gold or jewellery can also be considered as suitable supplementary collateral. The maximum borrowing power of each individual member should not be exceeded. Loans to borrowers should be secured from the Central Banks alone and resort to local money-lenders or sowcars should on no score be allowed. To relieve the excessive dependence on the Central Banks the primary societies must be started with a share capital basis payable in annual instalments and a Reserve Fund has also to be accumulated rapidly. Loans have to be distributed to members promptly and the forecasts of primary societies'

needs can be sent to Central Banks who can make prompt provision for the making of these loans. The village primary societies must be allowed to open current accounts in urban banks and allowed to draw upon them by cheques. This would achieve a dual purpose. Firstly cheques would become more popular and as the retention of cash in the hands of office-bearers gives scope to fraud, misappropriation, or any other defects these can be safely remedied by the above method. The village societies would do well in imitating the money-lenders' services and like him combine other lines of useful activity to help the borrowers. Without unduly sacrificing the financial aspect of its business it can act as a multiple 'general purpose society'¹ instead of being purely a credit society alone standing in isolation even though no co-operative sale or purchase society is operating in the place. As India is mainly an agricultural country more Raiffeisin credit societies should prevail with suitable modifications to suit the conditions of the different provinces. The Schulze-Delitzsch form of urban credit should be adopted on a wider scale. It is not the expansion of the co-operative credit societies alone that is required but the co-operative current must be directed in other channels such as marketing, purchasing, building purposes and productive directions and for the improvement of the backward or the depressed classes and the Criminal Tribe Settlements. Without such parallel efforts in other directions mere credit societies alone cannot hope to make the village people better men, better farmers and better citizens and secure an improvement in their standard of living.

Suggestions for improving the Central Banks.

The Central Banks must take up the current accounts of local individuals, traders and businessmen and with their properly trained office-bearers undertake to spread banking facilities in the interior. They must develop into complete self-governing local bodies and not degenerate into mere branches of the apex Provincial Co-operative Bank. They must in turn pay proper attention to the village primary

¹ The Royal Commission on Agriculture however recommends the single purpose society alone. But in the absence of adequately educated people in the village no real progress can be achieved if the co-operative movement is not used to increase the economic progress of the village.

societies and should not consider them as mere channels for distributing their credit and kill all initiative, individuality and real spirit of co-operation in the village societies. They must be arising out of the necessity of the primary societies for centralisation and must tend towards cementing their growth and organisation. Though the absence of propagandist bodies is forcing the Central Banks to confine their attention to propaganda, organisation, education and supervision of societies yet they should realise that "the Central Bank is when all has been got ship-shape to serve not to be tutor to the local banks. It is in fact designed to be a bank." Their main duty is to finance and nourish properly the different village societies. They must tap local capital for local use. So long as a large staff for organisation, supervision and control of the societies is not available the Central Banks would have to do this work to improve the quality of the primary co-operative societies. In the absence of broad-minded education, advanced outlook and experience of the outer world on the part of the generality of the people dependence on trained staff is necessary. Expert executives and business directorates are essential in the absence of general intelligence and business instincts. Co-operative bank directors and honorary organisers should take their responsibilities more seriously and exercise them more selflessly. It is high time to realise this higher and nobler conception of their duty. Much time is wasted in securing loans as the application of the individual borrowers has to be passed by the Central Bank which has to provide the necessary finance when the village societies are in lack of the necessary funds. The lump sum distribution of the Central Banks' loans is often made to those who do not immediately stand in need of it at that particular time. There should be real co-operation between the Central Banks and the guaranteeing unions or federations in the maintenance of a trained staff which can be utilised in the matter of inspection or supervision. The Central Banks should forsake all anti-co-operation spirit and instead of conducting business on joint-stock principles should realise the true spirit of co-operation. Some of the Central Banks in Madras have too large an amount of deposits to be safely loaned out to borrowers and the anxiety to pay the depositors is forcing them to make unco-operative investments. The idle balances of the Central Banks should be passed on to the P. Apex banks which can make a business use and investment of the



same funds in the money markets of the country. It is folly to refuse taking further deposits on the plea of idle balances. It is far more advisable to lower the rate of interest or simply hand them over to the P. Banks for a safe use of the funds and return of the same. Another vicious practice that has to be strongly condemned is the refusal to grant loans to primary societies on the score of their overdues. The net result of this action is forcing even the creditworthy members of the primary societies to the arms of the money-lender.

(The provincial co-operative apex bank must act as a link between the co-operative financial system, the money market and the State. Interlending between the provincial apex banks has to be encouraged and further mutual assistance in the direction of purchasing or selling securities has to be developed. Their working and business methods must be improved greatly. More facilities from the Imperial Bank in the matter of internal remittance must be obtained. They are to act as the guide, friend and philosopher for the different central banks. Their loans to the central banks must be made for productive purposes and preference must be given to produce loans or crop loans instead of loans for redemption of existing indebtedness or for enabling the agriculturists to make large-scale agricultural improvements. These form the main duty of the mortgage banks and no confusion ought to exist between the two types of loans. Both the Central as well as the Provincial Banks can grant loans on the security of deposits to non-member depositors. The present centralised organisation of the co-operative system is good provided it does not become commercialised or officialised or top-heavy and unnecessary duplication of efforts and consequent waste of energy is avoided. The guaranteeing unions, the Central Banks, the district federations, the Provincial Co-operative bank and the Provincial Co-operative Unions can with some more experience increase the efficiency of the weak and incomplete federated structure and other countries would do well to learn the future of coherent organisation from our country. For the present there are no serious fissures in the co-operative fabric. While in other countries, notably Germany, there is no real union of agricultural and urban co-operative organisations India has from the beginning been blessed with real union and all co-operative societies are attached to the same federation or union and there is a nation-wide organisation devoid of any separatist tendencies. If mutual

lending between the apex Provincial Co-operative Banks becomes a settled fact there would be great advantage of this procedure. As in the Italian and the Dutch Co-operative systems political and religious rivalry does not mar the utility of the Co-operative Banks. Religious or communal strifes should never be introduced into the co-operative movement at any cost or else the tragedy of the Italian Co-operative movement would be enacted in this country.

State spoon-feeding has been rightly given up and if the deposit-attracting function becomes a settled fact there would be the accumulation of savings. A high standard of fluid resources must be maintained by Provincial as well as Central Banks. Educational propaganda is needed in this direction. The Central Bank of Issue of this country that would be created should not fight shy in financing the provincial banks thus establishing a link with the rural credit system of the country. Government audit, supervision and control which are outlined in sections 35 and 36 of the C. S. Act of 1912 must continue till expert non-official executives can be secured. The undertaking of arbitration and liquidation of societies should be performed as usual by the Government Department.

Co-operate with the International Co-operative Organisation.

Such and other present-day problems facing the co-operative movement have to be solved tactfully and the prophecy that the co-operative movement is bound to become a permanent asset of immense value to India would become an actual realisation one day or other. It would enable the co-operative system of our country to take its due position in the International co-operative banking system. An International Co-operative Bank might be an imaginary phantom for the present. Separatist economic tendencies and political difficulties stand in the way of the realisation of this ideal dream. A great degree of international co-operation is wanted to make this scheme a success. The idea for the present is as vague and nebulous as the proposal for the starting of an International Bank¹ which can afford

¹ For an account of the various proposals to start an International Bank see the proceedings of the International Financial Conference, Brussels, 1920, Paper 12, pp. 77 to 82.

a legalised international means of payment or an international currency of account with a stable relation to gold. The International Co-operative Alliance is undoubtedly doing much spade work in this direction and the future development of co-operation in all countries must be on lines chalked out by this International body. Such a wise measure, recommended by the Twelfth International Congress held at Stockholm in 1927, as the co-ordinated working of the exchange and trading relations between agricultural and consumers' co-operative societies is bound to be accepted in all countries. Collaboration of the co-operative banks, agricultural co-operative societies and consumers' Co-operative Societies in the common endeavour of solving the problems of the rural society is bound to be of great benefit and a united community based on mutual self-help would be formed.

The Co-operative Credit Society vs. the Joint Stock Bank.

It is imperative at this stage to recognise the vast difference that exists between a co-operative banking institution and the commercial bank. The business of the commercial bank is to create credit and place it in the hands of the deserving people of the community. It acts as an intermediary between the lenders of money and its borrowers. It collects small savings and turns this broad stream to fertilise and irrigate the channels of industry and commerce. It grants loans on the strength of adequate security entrusted to its hands. Occasionally it permits people of undoubted personal security to overdraw their accounts now and then for a short time. It discounts bills of exchange arising during the course of trading transactions and by purchasing the trade bills it grants the needed money to finance trade. This, briefly speaking, is the work of the commercial bank which is familiar to everybody. It brings prosperity to all parties concerned in the matter but unfortunately it makes the rich richer and in no way benefits the poor man and does not uplift him to a higher place in the society. Only a few fortunate rich can satisfy the exacting requirements of a commercial bank in the matter of security. But the poor by virtue of their poverty are handicapped. It is here that the co-operative bank comes up to fill the gap. The co-operative bank is the poor man's bank or peoples' bank as learned

writers put it. Its main duty is to democratise credit and place it in the hands of the poor who, though they may be entitled to credit, scarcely get any recognition at the hands of the commercial bank.

The co-operative bank acts not only as an intermediary between the lender and the borrower of money but it tries to inculcate principles of thrift. In the very process of obtaining credit from the co-operative bank there is scope for education. As M. P. Francais has written "the co-operative banks democratise credit, relieve distress, create wealth and turn to good account industrial and agricultural opportunities." The hitherto isolated people learn the value and powers of association. In the very methods of providing credit the co-operative bank teaches the lessons of self and mutual help and suggests the extension of these to outside matters other than credit and thereby promotes insensibly their own self-development. Already we notice a humble start being made in the direction of sale and purchase societies to benefit the agriculturists and town-dwellers. In the matter of financing cottage industries and the building of houses the co-operative movement has been enlisted and it bids fair to pervade every activity of our social life.

If the moral and economic progress of the rural population has to be secured it can only be done by extending the real spirit of co-operative organisation in the field of education and industry. The co-operative organisation must not be understood as purely 'a strict business organisation' caring solely for the pecuniary advantage of the members. This objective has to be transformed into the one of common productive enterprise and the co-operative organisation must be understood as a fully "socialised method of organising the economic and cultural life of the different groups of society." In the production and sale of agricultural products, the purchase of implements, raw materials and manure, the furtherance of irrigation projects, the consolidation of agricultural holdings, the insuring against agricultural risks, the opening of dispensaries and schools, the improvement of livestock, the construction of new roads, and the combined bargaining for reduced railway freights, the cementing bond of co-operation would be an invaluable boon. It is in the Province of the Punjab we find agricultural non-credit co-operative societies flourishing and this is no doubt due to the remarkable work of

the Punjab Economic Board of Rural Enquiry. In a model co-operative village in Kashmir the co-operative movement is in full swing. Credit, sanitation, education and consolidation of holdings are looked after by co-operative societies and every villager is a member of these societies. The enlightened ruler of Kashmir has remitted a quarter of the annual revenue of the village as an appreciation of the work and further incentive in this direction. The novel experiment of allotting land to middle class families for agricultural purposes is also being tried in the province of Bengal. But co-operative research stations, post-offices and hospitals can be started as has been done by the Dutch people. Co-operative labour societies so peculiar to Italy can also be started among the permanently settled labourers of the Indian industrial cities to mitigate the influence of building contractors and ex-middlemen or *sardars* who undertake to recruit labour for factories and big employers. Smaller municipalities can encourage them by employing them in road-making, bridge-making and drainage-schemes, if any such exist.

The commercial bank is a joint-stock bank where the expert manager or the managing director plays an all-important part and the share-holders are sleeping partners. On the other hand the co-operative bank resembles "a piece of active machinery in which every spring, every wire is alive and knows and consciously performs its duties being endowed with the capacities of rendering discriminatory service according to the merits of each case watching and checking the other parts." There is common control, wide publicity and efficient supervision in the co-operative bank. There is a sense of responsibility in the minds of each member. There is discrimination in the selection of loans. Utmost vigilance is exerted in the control of their employment. Thus there is much of self-education in this case. The co-operative bank has certainty of custom and a well-known market. The quality of customers is all that is desired because "the customers have passed through the sieve of selection and having been tried and approved are held fast by the powerful bond of joint-stock interest and common liability." The commercial bank has no such advantage.

The co-operative bank operates with small working capital and insists on prompt and easy payments. It succeeds in turning over its

money with comparative rapidity. The co-operative bank takes special safeguards to protect itself against the bad debts. They are the linking up of the liability of all and the insisting of the productive use of money that is lent. The co-operative bank is near and familiar while the commercial bank is distant and unfamiliar to its customers.

The co-operative bank is a successful 'tapper' of savings. It affords a better rate of interest to the people. There is more remunerative employment of its fund than in the case of the Government Post-office Savings Banks. These are subordinate to the Government. Like the co-operative bank the savings banks do not educate and train savers to independence and enable them to obtain business knowledge and promote self-reliance on their part. 'It is not self-government' that can be obtained in the matter of savings banks. A co-operative bank is the depositors' own bank and here "the money may be profitably employed in setting up workmens' dwellings, in settling small folk on land and money is made to fructify in productive employment." Savings banks are less personal than the co-operative banks and do more valuable service in the matter of thrift promotion.

Complementary Institution.

There is no antagonism between these different kinds of banks, one seeking to destroy the other or planning for the downfall of its rival. There is place for both these kinds of institutions in a well-organised credit system. The commercial banks hold the cash box of the market and have full control over the money market. The co-operative banks do not wish to dethrone them from this position. They wish to play a less humble role as "collecting banks" and not as rivals but as "feeders" endowing small people with moderate capital and train them to banking habits and prepare them for business with more capitalist institutions to which they are likely to go as they become wealthy. They educate and train the people towards habits of thrift and draw money out of hoards. The final end and aim of the co-operative movement is the "production of



fine human beings and not the production of rich goods."¹ This is the philosophy of co-operative banking. While such are the idealistic aims of the true co-operators who are guiding the co-operative movement it would be interesting to note how far these ideas have been realised in our country.

Economic Benefits.

Something has been done in reducing the rate of interest at which the agriculturist can borrow and the following table shows the rate of interest prevailing in the different provinces in 1926-27.² The saving of interest in this direction is one tangible economic result arising out of the co-operative credit movement. The local rates of interest have everywhere been reduced as a result of competition between the money-lenders and the Co-operative Societies. The habit of saving has been inculcated to a certain extent and the increase of share capital and the deposits speak eloquently of the impetus imparted to the people in the habit of saving. (But the real reason why greater deposits in village societies are not forthcoming is the high rate of interest that can be secured by private money-lending.) Even co-operators

¹ See Alfred Marshall's Address at the Co-operative Congress, Ipswich, 1889. Not one of these cherished ideals can be realised if the true spirit of co-operation is not understood. Co-operation is the real basis of human action and real co-operation cannot be assured if an overwhelming sentiment permitting joint action cannot be engendered by means of liberal ideas which seek to realise the common interests and the common good of all.

² See the Ninth Issue of the Progress of the Co-operative Movement in India, pp. 11-15

	Provincial Banks.		Central Banks.		Primary Societies.	
¹ Name of the Province.	On borrow- ing.	On lend- ing.	On borrow- ing.	On lend- ing.	On borrow- ing.	On lend- ing.
Madras	...	...	2 to 7½	7 to 8½	7½ to 8½	9½ to 10½
Bombay	2 to 6½	6½ to 8	2 to 7½	8	6½	9½
Bengal	3½ to 7	7 to 7½	2 to 9	3 to 16½	9½ to 10½	15½
Behar and Orissa	5 to 6	7	8	12½	12½	15½
Punjab	6	7	7	9	9	12½
Burma	7	10	9	10	10	15
C.P. & Berar	2 to 7½	7 to 8	4 to 7½	9 to 12	10	12 & 15
Assam	4 to 7	8 to 11	6½ to 8½	11	...	..
U. P.	No Provincial Bank		7	12	12	15

obtain loans from the Credit Society and redistribute the same in lucrative investment in the field of private money-lending for un-productive purposes.

Another great advantage of the co-operative banks is that they attract deposits which are of a "lying" character. As Mr. N. D. Beatson-Bell points out "the co-operative banks have weathered the crisis when many of the 'swadeshi banks' failed. They have weathered the crisis when the greatest war in history began and they have weathered many a storm already and in spite of these trials the co-operative credit movement is going strong." Mr. J. N. Mitra says that "while withdrawals from the post-office savings banks were fairly large and although there was a run on the Indian Joint-Stock Banks there was hardly any rush on the co-operative banks for deposits and this means the public has a good deal of confidence in the movement." It is these banks that can best tackle the hoarding propensity of the agriculturists. The employment of systematic collectors or home boxes to tempt people to put money in them would lead to the formation of the deposit habit.¹ These methods have been tried with success in America and adopted in Japan and are bound to succeed in our country also. The co-operative banks are already acting as compulsory savings banks and in many districts in India the cultivator deposits his money after the harvest time. This practice should be stimulated and when once the agriculturist is broken to thrift there is prosperity in store for him.

Non-economic Benefits.

Besides these economic benefits of the co-operative movement the social, moral and educative effects which can be reaped as bye-products are very many. Mr. J. M. Mitra says "instances can be multiplied to

¹ Since these lines were written this experiment has been tried in the Chittagong District by the Durgapore Co-operative Society and the deposits collected in the Home boxes amounted to Rs. 4,000. The Co-operative Dept. is trying to encourage the use of the Home boxes in other parts of Bengal also.

indicate the indirect effects of the movement, how it promotes the social and moral improvement of the people, brings about reformation of bad characters, creates a desire for education, encourages the settlement of village disputes by arbitration, discourages litigation, promotes a wider outlook on life and makes village life healthier in all its relations." An increasing sense of unity is prevailing in villages. The social effects are in no way negligible¹. Thanks to the provision (sec. 34, the C. Societies Act, 1912) which forces the registered Co-operative Society to contribute about 10 % of the net profits arising after the contribution to the Reserve Fund to any charitable purpose, the village education, sanitation and medical relief are being attended to out of these funds. In the United Provinces the Co-operative societies utilise this fund for looking after the sanitation of the villages. In Bombay the famine reserve fund has been inaugurated. Though the nucleus of the fund was originally provided by private donation yet it has received substantial increment out of the funds of the Co-operative Societies. Speaking of the utility of co-operative activity Mr. Wolff says,² "there has indeed never been a Midas-like touch of this beneficent power nor so fruitful a generator of popular education, stimulating with the growth of worldly possessions, the thirst for knowledge and the longing for higher treasures and knitting people together by a community of feeling into an enlarged family."³

Slow and Steady wins the Race.

While rural credit has made such rapid strides yet many of its votaries are not satisfied with this astonishing growth. Since Sir D.

¹ "The Naogaon Ganja Cultivator's Co-operative Society spent in 1925-26 Rs. 9,300 on maintaining three medical dispensaries and one veterinary dispensary in addition to defraying the cost of the buildings ; Rs. 10,000 towards the cost of primary and secondary schools, Rs. 4,000 on improving communications and also gave a donation of Rs. 1,000 to the N. Agricultural Association. It also maintains night schools and girls' schools."

² See H. W. Wolff, "Rural Reconstruction."

³ A tacit recognition of this led the French Government to grant ten million francs for the reconstruction of Co-operative Societies in the war-ravaged territories. In Germany and Italy also many Co-operative Societies were started immediately after the war. This has been due to the desire to eliminate the profiteer. Financial assistance was also given in Italy to the Co-operative Societies so that Agriculture and Industry may rapidly recover from the ferment produced by the war.

Hamilton pointed out the slowness of its growth other writers have been commenting on this self-same factor. Mr. G. K. Devadhar says, "we have to-day 750,000 villages and the number of co-operative societies is a little over 62,000. Out of this 52,000 are purely agricultural societies. Their membership represents a little over 17 lakhs. If we take it that one member represents one family we have to multiply the 17 lakhs by 5. That shows that out of our present population so much of the population in the agricultural areas are being served by the co-operative movement." It has been pointed out that "Rome was not built in a day" and if it had been it would not have become "the eternal city." What is required is caution, safety and enduring success. Co-operation needs quality, moral and technical and not mere quantity. Better management of the existing primary societies, checking the evils of unpunctuality in the payment of loans and the baneful practice of making book adjustments and taking *benami* loans is far more important at the present stage than the mere growth of many unstable societies.

Sir D. Hamilton says "the country is still in the grip of the mahajan." Mr. Wolff points out "it is the bonds of debt which shackle agriculture. It is usury, the rankest, most extortionate, most merciless usury—which eats the marrow out of the bones of the ryots and condemns him to a life of penury and slavery in which not only is economic production hopeless but in which also energy and will become paralysed and men sink down beaten into a state of resigned fatalism from which hope is shut out and in which life drags on wearily and unprofitably as if with no object in view. There is no use denying the fact. It is plain to all eyes." These remarks are amply substantiated by a study and the problem of agricultural indebtedness of British India. Now that his two Richmonds "thrift" and "modern credit" have been created by the co-operative movement it would take some time to solve the present indebtedness of the agriculturists. The poverty problem is a wider one and although indebtedness is one cause for economic poverty yet its extinction would not remove the basic reasons for the poverty of the individual character and social life of the agriculturists.

*Extension to other Fields of Activity.* ✓

To realise greater benefits out of the co-operative movement the co-operative current of activity must be advanced in other directions.¹ There should be simultaneous advance in other branches of co-operation. Agricultural improvement by purchase and sale and insurance societies, the undertaking of contract work by the co-operative labour unions, building societies, rural reconstruction societies, industrial co-operation, consumer's co-operation including the permanent labourers and lower classes of people in cities and many other forms of co-operative organisations are needed if economic relief is to be secured. Co-operation is undoubtedly the greatest instrument in the field of social reconstruction. With larger amount of capital, constructive skill and forceful ability a co-operative commonwealth can be created and India would have no need to experiment with the other alternatives to capitalistic organisation such as communism, state socialism, syndicalism and joint control in industry. The co-operative movement is the most effective level to move the wheels of economic progress in this country.

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CHAPTER XIII

THE NEED FOR BANKING REFORM

The shortcomings of the existing Banks—Lack of close-knit organisation—Poor imitation of the Western Banking system—Lack of industrial finance—No proper rural credit organisation—Lack of co-ordination between the two groups of the money market—Lack of properly planned contact between the Co-operative Banks and the money market—No properly organised investment market—The real problems before the Banking system—Short sketch of Reorganisation.

The Existing Banks and their Shortcomings.

The existing Indian Joint-Stock Banks can be divided into three classes, i.e., the Imperial Bank with its close relation with the Government of India, the immigrant banks, and the local joint-stock banks. The Imperial Bank finances the internal trade to a great extent by discounting hundies and a few commercial bills that are drawn in connection with external trade. The immigrant banks develop Indian trade with their own countries and naturally assist their own countrymen engaged in the economic development of our resources. It is only with their surplus funds that they give help to Indian-managed industries carried on on a large scale. The bigger local joint-stock banks imitate the Imperial Bank of India and conduct commercial banking. Sometimes they lend money on mortgage of Zemindary properties in preference to industrial securities. Some of the loan offices in Bengal lend to the Zemindars on the security of immovable landed property¹ or houses, jewellery and goods. The private merchant banks conduct "mixed banking" business and there is no specialisation of discounting functions or acceptance business on their part. They have not reorganised their business and developed into modern bankers.² They have not imitated the practice of private

¹ The Rungpore Loan Office Limited which was started in 1894 now owns a big Zemindary estate with an annual income of Rs. 40,000. It lends to its own tenants on the security of occupancy holdings.

² In Japan several of the old merchant bankers developed successful banks. Many of the leading modern banks in Japan such as the Mitsui and Konoike are directly descended from the old merchant bankers.

bankers of other countries who publish balance-sheets in order to inspire confidence in the minds of the depositors. They have not entered into private partnership with joint-stock Banks on the well-known "commandit" principles which are followed in Germany.¹ But the financing of internal trade is largely in their hands and it is a matter of great doubt whether a Central Bank for India can really control the credit situation when these private bankers do not form a part of the recognised credit structure.

Lack of Close-knit Organisation.

The existing banking system needs thorough reform. There is hardly a banking system worth its name. The several component banks do not remember their close affinity of relations and extend mutual help and sympathy. They do not understand the duty of a bank and a modern bank owes responsibility not only to its depositors alone but to all other banks and to the whole community. A system of banks can be aptly compared to a crowded city consisting of wooden houses, and a fire breaking out in one house soon spreads to several others and soon becomes a devastating conflagration. There is no use of each bank taking precautions for itself. Unless the general standard of precaution is high the banking system as a whole will not be a sound one. India does not possess a close-knit banking organisation as in the case of Germany, Japan, France or the United States of America. This absence of thirst for system or wholeness or close-knit organisation is chiefly due to the tendency of the Indian Banks to do business "each for itself." The Imperial Bank, the Exchange Banks, the Indian Joint-Stock Banks and the private bankers work severally and not collectively. There is lack of co-operation between the ordinary commercial banks and the Exchange Banks. The Exchange Banks have always striven hard to protect their business from

¹ The Darmstadar and National Bank is organised on this bond and the private bankers not only stake their personal fortunes but closely supervise the work of the bank along with the directors elected by shareholders of the Bank. Their special knowledge of banking is thus enrolled on the side of the Bank and about 20 per cent. of the profits after paying the maximum initial dividend to the shareholders is usually given to them as return for their capital and services. See Dr. J. Reisser, "The Grossbanken."



competition from the Imperial Bank or other Indian Joint-Stock Banks. There is no Central Bank to cure the weaknesses of the decentralised system of banking.

Poor Imitation of the English Banking System.

The Indian Joint-Stock Banks copy the tendency of the English banks which justify their existence solely on the ground of profits. They aim at becoming commercial bankers having very little connection with industrial finance. It is indeed true that short-term loans are granted to industries but they can never hope to sacrifice the principles of safety and liquidity of assets which commercial banks have always to keep in view. But commercial banks alone will not create the needed credit for our agricultural and nascent manufacturing industries. That the Indian joint-stock Banks have borrowed, copied and translated the chief features of the English Banks is an undisputed fact. They have copied the tendency of the English Banks in having huge authorised capital, a part of which is subscribed and out of which very little is paid at the beginning. Like the English Banks they wish to trade largely on credit. The Government of India has followed the British Government in its *laissez-faire* policy in the matter of banking business. Imitation for imitation's sake has produced unworthy specimens. The superficial elements alone have been copied while the really vital and progressive features of English Banking have not been engrafted on our system. Branch banking, Bankers' associations,¹ financial houses, bankers' institutes and guilds have not been created on the English model. The Imperial Bank does not possess the traditional glory, respect and power enjoyed by the old Lady of the Threadneedle Street in the London Money Market. There is a note worthy

¹ The British Bankers' Association in which is merged the English Country Bankers' Association, was started in 1919 to look after special questions affecting banks. The British Overseas Bankers' Association consists of the British banks having a London office. This was started in 1912. The Institute of Bankers, London, the Scotch Institute of Bankers and the Institute of Bankers in Ireland are formed mainly to facilitate the discussion of matters of common interest to bankers. See Chap. on Bankers' Association.

absence of control either by the government or by a bankers' association.

Again a part of the financial system alone has been imitated. The Indian banks are merely pursuing commercial banking. In England, besides banks there are trustworthy promoters, capable underwriters and issuing houses so that industrial companies derive invaluable aid from them. The following are some of the important private bankers, issuing and acceptance houses which have registered as "limited private companies."

Name.				Date of Registration.	Issued Capital.
					£
Lazard Bros. and Co., Ltd.	...	...	...	1919	3,375,000
Matheson and Co.	..	...	...	1908	200,000
Murrieta and Co.	..	...	...	1915	25,566
B. Newgass and Co.	..	...	...	1911	300 000
M. Samuel and Co.	..	...	...	1929	1,200,000

Some of the merchant bankers, acceptance, discount or issuing companies which are not pure partnerships are also unlimited private companies. Among them the most important are the following :—

Arbuthnot Latham & Co.
Robert Benson & Co.
B. W. Blydenstien & Co.
Brown Shipley & Co.
Child & Co.
Dent, Palmer & Co.
Dunn Fisher & Co.
Robert Fleming & Co.
Higginson & Co.

Charles, Hoare & Co.
Frederick Huth & Co.
A. Keeper & Co.
Samuel Montagu & Co.
Morgan Greenfall & Co.
Newmann Luebeck & Co.
Sale & Co.
J. Henry Schrooder & Co.
Sparling & Co.
Thompson T. Bonar & Co.

In addition to the above there are the following partnership firms in London conducting discount, acceptance or issue business.



Messrs. Drummond.
Anthony Gibbs & Sons.
Goschen & Cunliffe.
Issac & Samuel
Knowles & Foster.
Stern Bros.

Konig Bros.
R. Raphael & Sons.
A. Ruffer & Sons.
N. M. Rothschild & Sons.
Seligman Bros.
Speyer Bros.

In the absence of such specialising concerns it is but natural that the Indian industrialists would look forward to their banks for this kind of business also. India made an unwise choice in selecting the English banking system as her prototype. The economic progress of Japan is solely due to her selecting the salient features of nearly every banking system in the world and engrafting them on her own banking conditions. The specialising tendency visible in the English banking system is noticeable in Japan. It has imitated the model of the French mortgage banks. It has copied, though to a limited extent, the useful branch bank system. It has borrowed the continental system of close relationship between the small banks and the central bank of the country. It has encouraged the co-operative credit societies. As in the United States of America there is stringent banking regulation binding the ordinary commercial banks.¹ It committed the mistake of imitating the U. S. A. national banking system and after a short trial it gave it up for the central banking system with the Imperial Bank of Japan as the crowning head of the banking edifice. The whole credit system was thoroughly organised by banking experts borrowed from foreign countries. State help and control enabled the banking system to work tolerably well.²

¹ See "Banking Reform in Japan, 1927," *Banker's Magazine*, London, March, 1928.

² Taking the recent banking crisis in Japan in the Spring of 1927 the state had to empower the Imperial Bank of Japan to advance loans to the Bank of Taiwan up to 200,000,000 Yen and a greater sum of 500,000,000 Yen to help the other banks. To solve the problem of smaller banks a new bank called the Showa Bank was organised with the help of the bigger Tokyo Banks and in the problem of financial adjustment the Japanese State took a prominent part. It has been encouraging the problem of amalgamation of the smaller banks. It has strengthened the staff of Bank Inspectors to enforce a rigorous application of banking Law. As the industrial and financial situation are both healthy the task of restoring order could be accomplished easily. See Appendix of this book.

Many of the bigger and successful banks operating in this country are managed by foreigners who come only into contact with "a few of the aristocracy." Petty traders and small handicraft industrialists do not receive much help from them. So they have to pay high rates of interest for any accommodation they may get from the private bankers or the public and sometimes thriving industries suffer from insufficiency of capital or a newly created industrial company locks up the whole of the share capital in fixed assets and even to commence its operations it is handicapped to a large extent by lack of outside help from bankers specialising in industrial finance. Thus there is a total lack of co-ordination between domestic and foreign finance.

The financial organisation of rural trade and credit is not properly designed. The existing banks do not care to change the present methods of rural credit. It is growing more evident day by day that the present insufficiency and waste involved in our export trade business should be rectified as early as possible. Our export trade is left to the mercy of funds outside the country. As in "capital poor countries" our export-trade is financed by the importing country to a great extent. Most of the big export and import houses are in the hands of foreigners who employ their agents to collect the produce from the interior and send it to the port centres whence they are shipped at their own risk and cost. The agents sometimes necessarily finance the cultivators from the beginning and the crop is practically hypothecated to them. This system of financing our internal trade for exportation purposes by capitalist exploiters is not to our best national interests. The chief harmful result of this process is that the capitalist merchant houses are exploiting agriculture in their own interests. The export of rice and wheat is increasing while their production is not on the increase at all when compared with the growth of population on the other side. Cotton and jute cultivation is increasing while food production is not progressing satisfactorily.¹ The production of non-food crops for export purposes is chiefly due to the influence of cash advances of the foreign

¹ Since these lines were written Professor Wadia and Joshi have constructed figures to show the comparative growth in the cultivation and export of the food and "non-food commercial" crops. See *Wealth of India*, pp. 214 and 216.

capitalist merchant houses. Thus our economic prosperity is mainly dependent on these firms. The real producers get unduly low prices and the necessity to make cash payments of land revenue, rent or interest forces them to sell when the market is practically glutted. A change is needed on the marketing side and this cannot be accomplished without adequate financial support. Even in the matter of non-export crops the capitalist-money-lending traders who combine banking business also, finance these cultivators and advances are granted before the time of sowing. These traders are the *sowcars* or money-lenders to the cultivators. These also undertake to finance the import trade in such articles as piece-goods from the port to the up-country trading or distributing centres.¹ This inequitable system of exploiting agriculture and rural cottage industries either in the interest of foreign exploiters or capitalist money-lenders should be given up. The introduction of the co-operative credit movement coupled with sale and purchase societies will go a long way in remedying this state of affairs. The question of removing this rapacious middleman requires patient tackling for a long time. Proper and

¹ The following table shows the rates of interest which money-lenders charge in the different provinces and what profit the financing middlemen often get by tacking on marketing side of business also to their money-lending operations.

Provinces.		Rates of interest charged by the money-lender 25 to 60 % lent.	Money-lending Middleman's Commission in marketing.
Assam	...	Average rate is 36 %	47½ % in three months.
Bengal	...	36 to 48 %	20 to 25 % Middleman's Commission.
Behar and Orissa	...	No information given	No information.
Bombay	...	No money-lending in the rural parts as elsewhere in other provinces of India.	The bania's or adatyas' rates are not quoted. ¹
Burma	...	Kind loans to be repaid after harvest. Rs. 60 loan to be repaid after 8 months in paddy worth Rs. 160.	No information.
Madras	...	No information	No information.
The Punjab	...	"	"
Sind	...	"	"
The U. P.	...	"	9 pies to 18 pies } in the Re.

See Appendix to Report of the Agricultural Commission, pp. 26, 47, 67, 92, 107, 122, 136, 173, 216, 218, 306, 353 and 421.

organised co-operative banking must play the chief part in the financing of internal transactions. At present there is too great a strain on the capitalist merchants whose hundies are discounted by the indigenous bankers and their rates of interest and discount are high, and unless these form a part and parcel of the organised banking system this strain would not be relieved. Very often there is a considerable "spread" between the rates quoted by the Imperial Bank and the indigenous bankers. This points out the necessity of securing complete co-ordination between the two groups. A Central Bank alone can succeed in co-ordinating the banking activities of the nation and in securing such control over the credit policy of the other banks as is enjoyed by the Bank of England in the United Kingdom.

The powerful immigrant banks whose sole business is the financing of our international trade display no desire to take part in the economic reorganisation of our country.¹ They have no ambitious national programme for India's economic uplift. These banks remain distinctively foreign—much the same as they were at the start. It is often stated that they are very willing to help their own countrymen and finance the European business firms and "agency firms" and are not anxious to attract the accounts of small and new firms started by the Indian people.² An Indian firm trading under a European designation is more fortunate in obtaining accommodation from these banks.³ They have never cared to refute any of these criticisms.⁴ These are some of the drawbacks of the existing powerful banks. On

¹ For a detailed account of their work in financing foreign trade and industrial ventures such as cotton and jute mills, tea gardens, and coal mines, see the Indian Industrial Commission Report, p. 9.

² See the Evidence of R. L. Sutaria before the Indian Industrial Commission, Vol. IV, p. 291.

³ See Mr. Manu Subedar's Evidence before the Sir H. B. Smith Committee. See also the evidence of Mr. D. P. Khaitan before the Indian Fiscal Commission. Mr. T. C. Goswami repeats this same point and says that the Imperial Bank while extending credit does not treat Indians in the same way that it does its European customers. See External Capital Committee, Minute of Dissent, p. 24.

⁴ The Indian Chamber of Commerce questioned the P. and O. Banking Corporation as regards its practice of refusing to lend on Life Insurance Policies of sound Indian-managed L. I. Companies. But no reply was given to the Chamber.



the other hand it must also be recognised that the Indian-managed companies often fail to exhibit their financial position in a business-like manner to convince the European manager as to the safety of loans granted to them.

Although the co-operative movement has already become an important wheel in the financial machinery of this country yet its importance has not been sufficiently realised by the Government or the other members of the money market. As the deposits of these banks are increasing and as they have to hold gilt-edged securities against them, the Finance Member should realise that there is an expanding market which will enable the Government to obtain more finance for productive works in the coming future. The Finance Member should count on these immense potentialities instead of relying on the unstable deposits of the savings banks. An attempt should be made to fit in these co-operative banks into the financial machinery of the country so that their seasonal glut of surplus funds might be unloaded on the money market. The surplus funds of the money market during the summer season might be safely lent through the Provincial co-operative apex banks to finance the agriculturists just at the time when they require it. The present system of water-tight compartments of rural, government and commercial finance is essentially backward and is a barbarous relic of the older times that should be swept away at the earliest opportunity. The first step in the reorganisation of the financial machinery of our country has been achieved by assimilating government finance with the commercial financing agency and what is required at present is to forge a strong, lasting and desirable link between the three systems so that equilibrium of monetary demand and supply can be achieved with comparative ease. Increasing use of notes, cheques and bills of exchange can be brought about by the co-operative banks as the landlord and the sowcar begin to deposit their savings in them.

There is no investment market in the country. Both short-term and long-term investment securities should be saleable in properly organised stock exchanges and cash obtained by the holder. It is undoubtedly true that fluctuations in the value of long-term investment would be within greater limits than in the case of the short-term security. The investment market is only a part of the capital market and its indebtedness to the banks is apparent. Without an

organised capital market it is not possible to think of an organised investment market within the country and investment banking cannot succeed unless our capital resources are thoroughly mobilised by the commercial banks. In the absence of such an investment market industrial companies find it difficult to obtain loans. Industrial investment practically comes up to locking up of money at present. Our stock exchanges do not facilitate the quotation of a new company's shares unless the promoters are well-known. The stock-exchange brokers have a few favourite scrips and any amount of skilful manipulation in their value is done in accordance with the bull or bear tendency of the times. Similar speculative tendencies exist in the produce markets such as Jute and Hessian.

Real Problems before the Banking System.

It is indeed high time that our banking system should be reorganised on a healthy basis giving scope for the proper mobilisation of our monetary resources. The healthy development of our trade, the careful promotion of our industries, a wise economy of precious metals and the real increase of our national wealth—these are the real problems that a soundly organised banking system has to solve.¹

The present banking system should be thoroughly overhauled and reorganised on an improved basis. The non-existing materials should be created. The exceptional position, unrivalled organisation and vast knowledge of the Imperial Bank should be utilised to work as the initiator of banking facilities in this country. This is far more important than the other suggestion that it should be made to serve as a World bank or the most important Indian Exchange Bank. A Central Bank should be created to perfect the currency and credit organisation of the country and to work in close association with British bankers and assure them that India will be able to participate in any scheme of Empire banking that may be inaugurated in the near future.² Agricultural and industrial credit for short

¹ A leading English banker echoes the same opinion before the Hilton-Young Commission where he says that "the development of banking in India is important from the point of view of currency, a counterpoise to hoarding, an incentive to economy, in the use of currency, a stimulus to private saving and investment in interest-bearing securities instead of gold." See Vol. V, p. 261.

² The present method of divided control of Indian finances—partly in India and partly in Whitehall—has to be given up. The control over Indian finances should be vested solely in the hands of the Finance Member of the Government of India.

period as well as long-term purposes should be created by new banks specially designed for such purposes. Just as the co-operative credit movement is borrowed from Germany, the German feature of close relationship between industry, finance and transportation is also worth imitation.¹ Indian economic development cannot be fostered unless there is a close alliance between banks and industries as in the case of Germany or Japan. Either new industrial banks having nothing to do with short-dated deposits should arise or the existing banks should take up industrial financing under proper safeguards. Full facilities for long-term investments should be created. Competition for deposits can be checked by following the salutary practice of linking the deposit rate with the bank rate of the Central Bank and keeping it 2 per cent. below it and raising or lowering it in conformity with the bank rate. The adoption of the banks' acceptance and establishment of a discount market are essential. The Government should see that there is no abuse of the word 'bank' as in the past and by restraining legislation smooth the progress of the banks. A close nexus has to be established between the organised money-markets and the bazaar or the indigenous system under the leadership of the shroffs. An attempt should be made to profit, from the experience of the continental countries, by copying all their deserving features. The English banking model is not the best model nor is it suitable to our present needs. Dr. Alfred Marshall, the leading English economist, was quite correct when he wrote that "England's was the worst currency model that India could imitate."² Even in the matter of banking business we should realise that our salvation lies in selecting the salient features of all banking systems and adopt them to suit our own special circumstances. Bankers in other countries have accumulated a great deal of experience and by a close study and comparison of their features

¹ The German banks do not aim solely at profit but consider the development of their industries as an important duty. One German director giving evidence before the American National Monetary Commission says that the "one difference between the banks of England and Germany is that in England the primary purpose of the banks seems to be to secure large earnings for their shareholders in Germany our banks are largely responsible for the development of the Empire and have built up its industries."

² See Dr. A. Marshall, Answer 11766, 1899 Committee on Indian Currency.

India would be in a position to select the most suitable ones. The way in which this has to be done is suggested in the following chapters entitled banking resources, banking management, bank organisation and banking legislation. The monetary control which the banks exert is next dealt with. However ramified the banking system would be it would take several years for it to be an agency of real potentiality to the country. Progress would necessarily be slow.

CHAPTER XIV

BANKING RESOURCES.

Banking resources and economic progress—More working capital to increase the economic equipment of the nation—The inadequacy of the present working capital—How to increase the deposits—Uniform policy towards deposits—Render gratuitous services rather than pay current accounts even—The hoarding habit—Its origin—Form of boards—Size—and relative magnitude—Causes for the hoarding tendency—Social causes—Economic causes—Remedies—Few thoughtless remedies—Conclusion.

Banking Resources.

Agricultural, industrial, and commercial progress is dependent on banking resources. They march with banking and the banking habit with them. It is essential therefore to secure proper banking facilities which are ample for her threefold requirements. A slow and steady policy in the matter of increasing the banking resources will assure the future of the banking system itself.

More Working Capital.

The first striking feature of the Indian money market is that banking facilities are inadequate, inelastic, insufficient and ill-distributed to meet the constantly expanding needs and requirements of the country. The fluctuating bank rate of the Imperial Bank has almost become an integral part of her banking system and though it has appreciably lowered the average bank rate to five and a half per cent. the relatively low and steady bank rate which all progressive countries of the world try to maintain and consider its raising as an unavoidable necessity due to acute stringency, has not been realised.

Financial facilities are an important desideratum at the present time in this country because a new era is setting in. Capital is required for the financing of new railways, developing forest and mineral wealth and constructing public works of a reproductive character.¹ The following table shows the increasing number of trading or industrial joint-stock companies started in this country.

¹ In 1925 the Finance Member estimated the total sum required for capital expenditure during the forthcoming years at 300 crores of Rupees.

Insurance.	No.	1903-4 Paid-up Capital.	No.	1913-14 Paid-up Capital.	No.	1923-24 Paid-up capital.
		£		£		£
Insurance ...	19	110	213	306	63	2,113
Navigation and general transport ...	29	2,303	65	5,540	216	14,703
General trading Cos. ..	288	2,906	826	2,187	1959	51,280
Tea and planting Cos.	150	2,433	230	3,037	453	16,340
Coal, Gold and Mining Cos.	74	1,759	215	7,871	354	27,424
Textile Mills and Presses	305	11,885	405	17,955	487	46,133
Flour and Sugar mills	29	422	55	989	67	1,939
Miscellaneous ...	80	1,161	159	2,683	422	15,826
Total ...	924	23,235	2168	45,528	4021	160,768

The economic development of our country would be seriously handicapped if sufficient capital is not available. "Money is the Alladin's Lamp which creates everything at will." The extension and development of the existing Jt. St. Companies requires a huge amount of capital. Thanks to the war, the activities of the Indian Munitions Board have manifested to us various new directions in which capital can be profitably utilised.¹ The agriculturists' demand for capital has to be reckoned. The funds for financing our foreign trade have to be taken into account and the total demand for capital under all these items would amount to a respectable figure. The internal trade of the country is certainly ten to fifteen times larger than the external trade.² For an adequate financing of these varied interests sufficient capital is needed.

¹ A number of new schemes to harness the waterfalls of the Western Ghats, the smelting of zinc and copper, the production of sulphuric acid on a commercial scale, the treatment of coke bye-products, the production of heavy chemicals and aniline dyes, the manufacture of textile machinery and mill accessories and the building of petrol and oil engines are some of the numerous industrial activities that are contemplated by the organisers of India's industrial development.

² The Internal trade was computed at 1,597 crores in 1919-20 and 1,497 crores for 1920-21 and 2,000 crores for 1921-22. As Prof. Fisher says the internal trade cannot be more than the amount of produce available for exchange. In India a great number of middlemen intervene between the producer and the ultimate consumer of goods. This leads to greater frequency of transfer of goods from hand to hand. The official method of calculating is to consider the amount of our produce once as exports and once as imports and the total figure is considered as the amount of internal trade.

Inadequacy of the Present Working Capital.

The amount of working capital that lies at the disposal of the Imperial Bank of India, the Exchange Banks, the Indian Joint-Stock banks, the Co-operative banks and the private bankers is totally inadequate for raising the needed credit structure to meet the situation. It is not commercial banking facilities alone that are needed but industrial and agricultural credit should be properly developed so as to produce satisfactory results. It must not however be supposed that our joint-stock banks do not aid the agriculturists or the industrialists. It is nothing but mere Physiocratic reverence for agriculture which Recardian Economics has failed to completely dispel even to this day that makes possible this line of criticism. Commercial Banks do help agriculture and industry, indirectly at least by making advances to the merchants to whom they can sell these products. Thus the broadening of the market is the indirect service that the commercial banks generally perform towards agriculture and industries. It would be easy to construct a table which shows the position of banking business in the principal countries of the world. It would show that the *per-capita* deposits and capital in India are quite insignificant when compared with other countries.

It is a well-known fact that many metropolitan banks of London possess more capital than all the Indian Banks put together as shown in the following table.

Name of the Bank.	Year.	Paid-up Capital.
		£
Barclays	1925	15,592,372
Lloyds	1925	14,372,956
London Joint-Capital City and Midland	1925	11,976,890
National Provincial and Union	1925	9,479,416
London Westminster and Parr's	1925	9,051,718

Speaking of the banking situation in India Mr. S. N. Pochakanawala, the leading Indian banker, says that the total deposits in India were only 3 per cent. of the bank deposits in the United States of America and 9 per cent. of the deposits in the United Kingdom."¹ There are still 500 towns in India with populations of 10,000 and upwards which have no modern banking facilities at all.² So the

¹ See his speech before the U. P. Chamber of Commerce, November, 1926.

² See India in 1926-27, p. 231.

outstanding fact is the smallness of the paid-up capital and the size of our banks. Sir Norcot Warren while placing the scheme of amalgamation of the Presidency Banks before the shareholders of the Bank of Bengal, openly admitted this weakness of our banking system. The proposed amalgamation, he says, means "added strength and more capital to our banking system." Some of the more progressive banks are increasing their capital in order to provide the needed credit facilities in our money markets.¹ This increase of paid-up capital can be considered as an indication of the stability of financial capacities of the banks. Banking enterprise is thus provided with fresh scope for its activity. It is a matter of increasing gratification to find that the Indian depositors are confiding

¹ The following table shows the increase of the paid-up capital of the Banks :

(000 omitted.)

<i>Name of the Bank.</i>	1918.	1919.	1920.	1921.	1922.	1923.	1924.	1925.
Ajodhia Bank (Fyzabad) ...	...	...	...	200	200	200	259	300
Allahabad Bank ...	3,000	3,000	3,000	3,550	3,550	3,550	3,550	3,550
The Bangalore Bank ...	440	455	548	589	600	600	600	600
The Bank of Baroda ...	2,020	2,041	2,412	2,990	2,999	3,000	3,000	3,000
The Bank of India ...	5,000	9,909	10,000	10,000	10,000	10,000	10,000	10,000
The National Financing and Commercial Corporation (now known as the Bank of Morvi)	1,066	1,089	4,000	4,029	5,501	5,501	1,500	1,500
The Bank of Mysore ...	1,000	1,000	1,932	2,000	2,000	2,000	2,000	2,000
The Central Bank of India ...	2,500	4,990	5,000	5,000	5,000	16,813	16,813	16,813
The Indian Bank (Madras) ...	1,000	1,000	1,000	1,259	1,278	1,229	1,229	1,229
The India Industrial Bank ...	...	...	326	343	463	...	...	...
The Mufossil Bank (Gorakpur) ...	199	300	400	403	447	471	472	473
The Mysore Industrial Bank ...	...	...	...	607	651	651	716	752
Nedungodi Bank ...	304	360	434	557	637	721	866	1,004
The Punjab and Sind Bank ...	322	326	376	384	390	394	399	401
The Punjab National Bank ...	1,645	1,659	1,853	2,046	2,675	2,740	3,066	3,084

Some of the Eastern Exchange Banks have also increased their capital but it cannot be denied that a large part of the working capital is located outside the country. The most noticeable feature of the expansion of the banking institutions is the progress of the Commercial and the Co-operative banks. Other aspects of banking such as industrial and long-term agricultural banking have been neglected.

more trust in the existing banking institutions. At any rate the Indian public are now slowly realising that "without banking capital there can be no credit and without credit the primitiveness of barbarity would remain."

Greater working capital should be at the disposal of the banks. Mr. (now Sir) M. DeP. Webb prophesied long ago that "India needs *more banks* manned by *Indian* men and furnished with *Indian* capital."¹ If India were to have banks in the proportion existing in Europe we shall require about 36,000 banks and branches. All of these should be conducting sound banking on secure business lines never sacrificing security to speed in the matter of extending the branches.

How to increase the Deposits?

To secure greater working capital our Joint-stock Banks would have to pursue some of the following methods to increase their deposits. It has already been stated that the deposit habit has been contracted to a certain extent and that bank deposits are on the increase. But there should be a greater drive on the part of the banks to increase the bank deposits. The most successful method is to see that the capital of the Bank is held by well-to-do men who patronise the Bank. Advertisement affords scope towards the securing of deposits. Sound management would go a long way in securing confidence and the Indian Banks should advertise the personnel of the bank officers. Periodical publication of balance-sheets will do much in this direction. Education of the depositor as to the different kinds of deposits and their respective advantages has to be undertaken. Personal solicitation by bank officers who are interested in the success of the bank must be carried out. If we take English banking into consideration the main causes that led to the growth of banking deposits were the following. They have opened branches in places where private banks did not exist. They have commenced acceptance business and have opened foreign departments. Their savings department is meant for the deposit of very small sums. The general development of industries and commerce led to increased banking deposits. Finally there was

¹ Italics my own.



remarkable freedom from bank failures due to scientific and conservative management.¹ Temporary set-backs occurred now and then during periods of crises but as soon as the normal state of business was once more regained progress in deposit banking continued unchecked.

Uniform Policy towards Deposits.

Any of the above measures can be pursued with infinite advantage by the Indian Joint-stock Banks. The existing banks must pursue a uniform policy towards deposits. The first thing that strikes the student of Indian banking is the high deposit rate paid by the banks and many people have come to the startling conclusion that "capital is more productive in India than elsewhere." Nothing could be further away from the truth than this broad and facile generalisation. The banks are forced to pay high rates in order to attract deposits and even commercial deposits which are practically payable at call are paid for.) The starting working capital of the banks is very low. They are forced to rely on deposits. They have formidable competitors in the co-operative credit society and the Government managed Post Office. The former pays a higher deposit rate; the latter affords greater security. Now that the Government borrows even for short-term purposes at a high rate of interest the banks are finding it difficult to obtain permanent or fixed deposits unless higher rates are paid. No doubt the value of money has increased but the grievance is that even current accounts have to be paid for with the result that touting for unsafe business has been resorted to.²

In the London Money Market the deposit rate is always linked to the Bank rate, i.e., 2 per cent. lower than it. The country Banks' deposit rate seldom exceeds four per cent. and usually ranges between 2 and 3 per cent. and in London the commercial current account deposits are not paid any rate of interest.³ The Bank of England⁴ does not pay even its fixed deposits but it is still able to

¹ See J. Sykes, "The Amalgamation Movement in English Banking," p. 114.

² How the Punjab Banks failed on account of this reason has been related in the chapter on the Indian Joint-stock Banks.

³ The balances of foreign banks are an exception to this statement.

⁴ During the recent war the Banks of England began to pay interest for short-term deposits, made by the Banks. This practice was discontinued from July, 1919.



attract the deposits of other banks, of the Government and of all the richer people. It is the custodian of the nations' reserve. The absence of such a dignified bank in India is a deplorable want and all banks scramble as it were for the deposits.¹

The practice of not paying commercial current account deposits is a sound one. The American Banks are trying to abolish the deposit rate for current account deposits and the Indian Banks should follow suit. It might be remarked that the apparent danger would be that the depositors would not be encouraged to deposit money. The fear that commercial deposits would disappear need not be entertained for the commercial class as a whole cannot dispense with its banking account. The Indian Joint-stock Banks should render gratuitous services in the manner the London Banks are serving their commercial customers for their unpaid current accounts.² Of course a united action on the part of all the Joint-stock Banks is required and the great advantage of this step would be that Indian Banks would not be compelled to undertake risky and unsafe business. This might seem a counsel of perfection but it is worth attempting.

The Hoarding Habit.

It is the duty of the banks to implant, foster, develop and universalise the banking habit. It is often stated that one of the chief causes hindering the banks in the discharge of that duty is the prevalence of the hoarding habit among the majority of the people. This hoarding which is indicated by the excessive importation of gold and silver and the non-circulation of minted rupees or imported gold sovereigns has really proved a nightmare. One of the arguments advanced against any scheme for adopting gold currency in circulation is the impossibility to estimate the amount of gold required for purposes of coinage, if the hoarded gold and silver rupees and bullion were to be converted into the standard gold coin. It is said that much of the gold put into circulation would disappear into hoards; and the example of 1907-08 is often quoted in this connection. There is no denying that this hoarding habit is specially adverse to the

¹ Several of the Banks pay brokerage fee for securing deposits.

² See Walter Leaf, "Banking," pp. 108 and 109.

efficiency and smooth working of the gold standard system and that it would render any currency system unautomatic. Western Economists say that the hoarding habit is about the most important cause of the poverty of the Indian people and the greatest hindrance to a real and vital economic development of the country. In view of these far-reaching consequences the problem of hoarding has always been a live issue with those who talk or write of Indian Economics.

Meaning.

The late Sir Lionel Abrahams wisely remarked that "there are two words in monetary science which have a very doubtful meaning. One is "inflation" and the other "hoarding." It is indeed extremely difficult to find any definition of these terms that is at all satisfactory. The real meaning of hoarding is the unproductive locking up or burying in pits or safes of one's savings or surplus of income over expenditure in gold or silver bullion. But unfortunately it is not used exactly in accordance with this sense of the term. Even a really industrial use of specie is mistaken for hoarding. Instead of condemning the excessive consumption of the precious metals as a needless luxury it is often confused with the hoarding tendency and both the hoarder as well the user of gold and silver are equally taken to task. On account of the lack of scientific exactitude 'hoarding' has become the most baffling problem in Indian Economics.

The Gravamen of the Charge.

All economists may admit, in a very general sense without subscribing to the deduction usually made therefrom, that the gold that is absorbed is never disgorged; that it is 'a sink for precious metals,' and that it will take long for India to become saturated with gold. Only during times of famine or when production falls off as a result of other causes does the demand for gold fall off; but India would commence buying gold as soon as normal conditions are reached. But leaving aside the question of the industrial use of gold we can first examine whether India has appropriated an unduly large share of the world's gold. In this connection the statements



of the Fowler Committee and the Babington Smith Committee¹ are directly to the point. The Fowler Committee says, "India's holding of gold and silver is not excessive; it does not create such political difficulties as to justify a permanent refusal of the gold currency circulation in India." As regards the recrudescence of the habit since 1920 special causes have been operating towards this tendency and nothing can be generalised from this particular instance.

The more scientific significance of the charge of hoarding is simply this. If gold comes into India in payment of the favourable balance of trade, the price level in India remains unaffected while the countries which send out that gold suffer from high money rates and depressed prices. No banking or business use is made of the imported metals. Broadly speaking the Indian people are not in active touch with the money market. A rise in the bank rate or any other stimulant such as the starving of currency fails to bring out the precious metals. The Indian hoarder is not a *homo œconomicus* but he is unable to understand the movements of the money market and usually keeps himself aloof from it.

This fact can be proved by a reference to the statistics of the export of gold from this country. Gold comes out in days of scarcity and of high prices; then it is exported out of the country. Immediately after the war, much gold was exported out of the country. Her ability to re-export gold is not entirely without significance. Even granting that an organised banking system exists in India it takes a very considerable time for the discount policy of the Central Bank to check this. Money is liable to come out of the hiding places and fill up the gaps; and contraction of currency by means of credit control exercised by a Central Bank cannot thus work out so smoothly as in highly developed countries. Unless cash is used only as a basis of the credit structure, the adjustment of internal prices to external must be a difficult and often an insuperable task. In all questions of capital, currency and credit the economic use of money must remain in the fore-front. But in India 'hoarding' has assumed a disproportionate importance and has vitiated the discussion on these topics. It is thought that even the poor people have with them hoards of rupee coins which would be

¹ Report on Indian Currency and Exchange, 1919, para. 63—

converted into standard gold coin at the currency office if the pure gold standard plan with gold currency in circulation is adopted by this country. Very great importance is attached to this liquidation of silver rupees or conversion operations which would have to be undertaken in case of the alteration of the exchange standard into a genuine gold standard system.

Origin.

As regards its origin there are people who trace this tendency of the Indian people to the days of Nero. There are others who regard India as the world's Silas Marner with an insatiable appetite for gold. As an interested student of economics, I have sought, so far in vain, to get hold of the full stock of correct economic facts necessary for a conclusive judgment. But the conviction has been growing on me that the so-called fabulous hoards should be looked upon less as a 'hidden danger' than as 'hidden reserve' against the economic difficulties that people may be put to in the future. I may give here the methods I adopted in my enquiry. I issued a general questionnaire (see Appendix) to the shroffs in the town of Vizagapatam and interviewed the leading shroffs. Considerations of space prevent me from printing the detailed results of the interview. As this is a burning topic I reproduce my general questionnaire in the Appendix and I must say that unless such a thorough inquiry is held in all cities, towns and places where gold and silver are bought and sold in retail by the shroffs, nothing conclusive as regards the hoarding tendency of the people can be learned. On the antiquity of this habit, there is, however, no inconsistency of opinion. Mr. H. D. Macleod was the first economist who started the theory of hoards and ever since that time the hoarding problem has almost become classical. He estimates the amount of Indian hoards at £300 million. Lord Curzon says, "The whole hoarded wealth of India amounts to over Rs. 825 crores. Think of all this money lying idle or at most put out for usury or relatively unproductive forms of investment." Arnold Wright puts it at £200 million. The Hilton-Young Commission has absolute faith not only in the hoarding propensity of the Indian people and the existence of hoards, but also believes that



silver coins for about 100 to 150 crores of Rupees would come out of hoards for encashment into gold coin. That was one of the chief reasons which dissuaded them from recommending the adoption of an effective gold standard with gold currency in circulation. At one time this school of opinion, in their anxiety to retain the gold reserve in London, pointed out not long ago, that prices would rise if the gold reserve were transferred to India. Obviously there can be no rise in the price-level unless gold is allowed by its holders to circulate in some form or other in the hands of the people. The inconsistency of these two contentions has not been, I am afraid, duly appreciated.

However it is encouraging that there are well informed people who have specialised in the study of the production and distribution of world's gold and who have given out their considered opinion that "there is very little real holding in India either of gold or silver."¹ According to this school the hoarding tendency exists up to a certain limit and beyond this it is a myth and an exaggeration. The general impression among Indian economists² and publicists³ is naturally, that India has not secured her due quota of the share of gold as yet. Even the Bengal Chamber of Commerce is of this opinion. The shortage of capital is attributed to the annual drain of money by way of Home Charges and it is contended that this drain is too big to leave any surplus capital in the country. As Prof. Marshall points out "capital can grow from the surplus of national income over national expenditure or in other words net national dividend." Any untoward call decreases the national income considerably and hence the national dividend is correspondingly reduced. There is no legitimate ground for grievance so far as the Home Charges are concerned, for they are a direct payment for services rendered to India but an appreciable amount goes away out of the country as profits of industries managed and financed by Europeans or other foreigners. Here is ground for legitimate complaint. The drain as it is styled impedes the rapid growth of capital in India. How is this problem to be tackled? Artificial attempts for the nationalisation

¹ Joseph Kitchin, "Oral evidence before the Hilton-Young Commission, Answer 13528.

² See Dr. Balkrishna's Memorandum before the Hilton-Young Commission.

³ See Sir Stanley Reed's Memorandum before the Babington Smith Committee (App. J. p. 130).

of foreign capital have failed elsewhere. It is unwise to raise artificial restrictions against the free flow of foreign capital.

The Indian Fiscal Commission had to consider this problem. The Minority report is anxious to raise some safeguards against the influence of the foreign capitalists. Such measures have failed in Germany and they have no better chance of success in our country. The only safe course is the accumulation of our capital so that our capitalists may become "the natural heirs of foreign enterprise." Quite recently, the External Capital Committee had to repeat the same idea in this connection. It is the paramount duty of every citizen who can save from his income to rid India of the domination of foreign capital and to obtain control of all the vital industries. As Lord Curzon says "a country is in the strongest position whose capital is self-generated and self-employed." It behoves them to understand the subject in its true bearing and consider its economic significance to present-day Indian society. It is also essential for our economic progress to correct the Westerner's mistaken notion that India would be sponging up all the world's gold as soon as the Hindus begin to grow rich.

Form of Hoards.

Whatever might be their form in the past, it is an unquestionable fact that except the ignorant people who are unaware of this tendency there would be few who hoard their savings in silver rupees which are so much over-valued. Silver hoards are also being replaced by gold hoards as evidenced during the years 1924-1925 and even now people prefer to buy gold bullion in small quantities of two or three tolas. The very fact that gold coin and bullion are imported and absorbed instead of the Government rupee as in the past shows that people have now realised the futility of locking up their savings in a depreciating metal. It is, indeed, true that about 150 crores are out in circulation but it can be safely supposed that they are meant to do the work of exchanging goods only and that hoards in shape of silver coins can hardly exist in the hands of educated and enlightened people. Silver ornaments are, of course, used by them and both gold and silver are used for ornamentation to a large extent by the Indian people, mostly womenfolk and children. Gold sovereigns to the

extent of nearly 100 millions are supposed to have been absorbed by the people and unquestionably the major portion of these must have been melted for ornaments.

Most people now appreciate that gold is a more desirable form than silver for locking up their savings. The poor man lays hands on silver only because he cannot obtain gold with his little savings. The generality of the people regard their ornaments as suitable for being pawned to the *sowcar* to meet the economic pressure on account of illness or old age. Strictly speaking the accumulation of these stores speaks highly of the prudent and thrifty habits of the people. If these slender savings are guided intelligently into the channels of banking and productive investment a double purpose would be achieved. Without impairing its usefulness as a provision for the future such investment would also bring in its own current a return which might act as a further stimulant towards savings. Education in the right form of investment or the economic use of gold is the only panacea. They must bear in mind the advice of Adam Smith that "coinage is unproductive capital; it does nothing but pass from hand to hand and is not put to any useful purpose whatsoever." Sir D. Hamilton rightly points out that "the gold sovereign is a cheque drawn on Europe." It is unwise to hoard it or lock it up in the family vaults for the sake of safety. Hoarded wealth cannot in any way increase the economic well-being of the hoarders.

Size and Relative Magnitude.

As to the possible size or exact composition of the hoards it is almost impossible to say whether there is more of gold or silver or whether more is in coin or bullion under each head. But it is usually thought that about £100 m. worth of sovereigns have been hoarded and that roughly 200 crores of silver rupees are in hoards with the Government and the people. Barring these conjectures nothing can be stated as regards this old, old problem. The following table shows the net imports and exports of gold of the various countries. From this it can be gathered that India is not the only country which is bent upon absorbing heavy stores of gold annually and that no conclusion can be drawn out of the figures for 1922-25 as India was starved of gold during the war years.

(In millions of dollars.)

Year.	U. S. A.	England.	France.	Japan.	Germany.	India.
1900	+ 13	+ 39	+ 64	...	+ 30	+ 0·3
1901	- 3	+ 34	+ 55	- 0·4	+ 49	+ 6
1902	+ 8	+ 29	+ 61	+ 15	+ 8	+ 29
1903	+ 21	+ 5	+ 36	+ 4	+ 45	+ 32
1904	- 36	+ 5	+103	- 50	+ 86	+ 31
1905	+ 3	+ 39	+125	+ 3	+ 35	...
1906	+109	+ 15	+ 52	+ 7	+ 65	+ 48
1907	+ 88	+ 29	+ 56	- 6	- 8	+ 56
1908	- 31	- 19	+192	+ 7	+ 83	+ 14
1909	- 89	+ 34	+ 35	+ 36	+ 5	+ 20
1910	+ 1	+ 29	+ 11	- 3	+ 43	+ 28
1911	+ 20	+ 44	+ 24	- 8	+ 28	+123
1912	+ 19	+ 29	+ 42	- 5	+ 40	+110
1913	- 28	+ 63	+ 99	- 10	- 76	+ 76
1914	-165	+136	+149	- 9	...	+ 25
1915	+421	-136	- 15	- 8	...	- 4
1916	+530	-102	+ 12	+ 39	...	+ 43
1917	+181	...	+ 15	+118	...	+ 82
1918	+ 21	...	+ 3	...	...	- 18
1919	-292	...	+ 11	+162	...	+115
1920	+ 95	-122	- 18	+196	+ 4	+ 10
1921	+667	+ 19	- 11	+ 65	- 0·07	- 14
1922	+238	- 24	+ 3	+ 0·4	- 2	+200
1923	+294	- 49	- 3	...	0·7	+142
1924	+258	- 44	...	...	+ 16	+344
1925	-134	- 39	...	- 13	+133	+146

¹ See the Evidence of the American witnesses before the Hilton-Young Commission, p. 290. Vol. V. (Net Import and Net Exports.)

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So far as silver is concerned India is undoubtedly one of the largest consumers of silver and the following table shows the silver consumption of a few prominent countries.

(In millions of fine ounces.)¹

Year.	World's production.	India.	China.	U. S. A.	France.	England.
1900	174	49	...	...	...	2
1901	173	39	...	...	..	4
1902	162	43	...	...	...	9
1903	168	79	...	...	7	11
1904	164	74	...	...	...	13
1905	172	84	...	...	...	13
1906	165	118	...	...	...	11
1907	184	98	...	...	40	7
1908	203	74	...	...	...	28
1909	212	61	...	...	6	9
1910	222	65	26	...	...	-27
1911	226	32	46	...	19	24
1912	231	91	23	..	...	13
1913	210	21	44	...	10	13
1914	172	56	-17	25	...	-10
1915	173	33	-22	24	20	-29
1916	181	92	-35	23	19	20
1917	187	75	-26	28	15	...
1918	204	137	29	-66	6	...
1919	182	71	65	-77	9	...
1920	173	4	113	29	...	4
1921	172	54	40	47	...	9
1922	214	68	48	48	8	18
1923	246	93	76	49	11	12
1924	239	87	32	55	11	- 9
1925	240	142	...	..	...	...

¹ See *Ibid*, p. 281. Vol. V. (Net export—)



Prior to 1900 there was the absorption of silver and Joseph Kitchin says that in the sixty years from 1834 to 1894, India absorbed silver to the extent of £320 ms. and for the 30 years since that date it can be calculated that she has taken £303 ms. of silver.¹ The aggregate absorption in the 90 years is 4,556 million of fine ounces or 34 per cent. of the world's production² and of this nearly two-thirds may have been converted into ornaments and jewellery or kept as a store of wealth.

While these facts and figures are reliable they yield no definite conclusions as regards the relative size of the individual hoards. Broadly speaking, there are very few large hoards and Sir Basil Blackett the Ex-Finance Member of the Government of India, also believes this fact; for in his memorandum to introduce gold standard with gold currency he explicitly says that "comparatively few hoards would be large enough to buy the minimum quantity sold by the currency authorities." He does not, however, consider the action of bullionists who might combine to draw out gold by presenting the needed quantity of silver. The bullion merchants might act as representatives of the hoarders and thus defeat the gold standard scheme.

The size of the individual hoard depends on the excess of income over expenditure and such surplus must result in some form of storing up or other, whatever might be the currency system of the country. It is necessary to consider the family budget figures in this connection. They all prove that the average Indian is very poor and his savings would not help him to hoard gold. Some gold trinkets he might possess. Of the agriculturists who form 72 per cent. of the total population the majority cultivate small and uneconomic holdings and perhaps are groaning under the weight of heavy indebtedness. Several receive grain advances and make repayments in grain and they seldom handle any appreciable stocks of money. It is no exaggeration to say that they have merely a living wage. Some of the wealthier agriculturists like those of the Chenab Canal Colony who have large holdings measuring 25 to 30 acres and who

¹ See Appendix 82, Hilton-Young Commission Report.

² See G. F. Shirras, "The Science of Public Finance," p. 467.

sell their wheat to European agents direct are in a position to save and they undoubtedly consider "the wife's person as their bank."

Large numbers of the artisan class live by their petty handicrafts. Neither they nor the bigger native manufacturers are in such a flourishing state as to accumulate hoards. The clerical class and the Government servants find it impossible to maintain their existing standard of life. Except when aided by ancestral property which is becoming more scarce, they find it impossible with their inadequate pay to escape indebtedness. The bulk of the teachers are low-paid and are in the same straits as the Government servants. From the recent enquiry conducted by the Bombay Labour Office the people of middle class of Bombay have an income ranging from Rs. 25 to Rs. 225 per month. On food and housing alone they spend 56 per cent. of their income. Clothing and other conventional requirements must be taken into account before the available surplus can be estimated. It is only a few successful lawyers, medical practitioners and other professional men who can save and since the days of the Swadeshi Movement they have to a certain extent come forward with their savings for investment in industrial ventures. It is these people who also invest in the Government Rupee loans. It is not possible therefore, that in addition to these investments and the ornaments they may possess they have much to lay by in idle hoards. Their education, training and contact with banking institutions would make them depositors rather than hoarders of their savings. Figures of the Income-Tax Assessors speak of the growth of on the part of businessmen, high salaried Government servants, successful lawyers and a few other classes. The saving number of people with incomes over 1 lakh of Rupees has increased to a much greater extent than that of people holding incomes above Rs. 10,000. Those earning between Rs. 2,000 and Rs. 10,000 also increased in numbers. The number of income-tax assesseees is on the increase. The bullionists, the Native States, the richer professional classes and wealthy landlords generally possess the capacity to hoard. But the proportion held by them cannot be estimated with any precision.

It is not the richer or middle classes alone who are prone to hoard. The Government itself is a great hoarder of both gold coin

and bullion and silver coin also exist in its Treasury to a greater extent than is normally necessary for securing the interchange of notes and rupees.

Some of the Native States like Hyderabad and Gwalior have also been sinners in this respect. Their stocks of the precious metals are neither a store of value nor a reserve of purchasing power as in the case of the ornaments of the middle and richer classes of people or the hoards of the Chetties and indigenous money-lenders. Of late the rulers of the Native States are shaking off the habit of hoarding and are now investing their funds in industrial enterprises. Some of the famous temples and shrines also possess hoards of coins which the devotees put in or offer as their thanksgiving to God.

Causes for the Hoarding Tendency.

The hoarding habit seems to have received sanction by the experiences of centuries in India. The state of the country at the time of the Mahomedan conquest was least conducive towards peace and accumulation of wealth. There was no middle class and a state of war without a permanent standing army was the result of the feudalism prevailing at that time. People lived in isolated and self-contained villages with little incentive for industrial development. Neither were the tools of the carpenter or the gold or the silversmiths or the braziers' elaborate ones requiring any investment of capital on a large scale. Though Mill and the latter-day historians have done their best to show the progressive rule of the Mahomedan rulers there was not much of organised industrial production.

One or two fine arts such as architecture, sculpture and painting might have been improved. There were indeed occasional periods of grace under benign rulers who changed the iron hand of oppression into one of silken gloves. Barbaric magnificence, insatiable benevolence and magnificent philanthropy were usually displayed by the princes but so far as the generality of inhabitants were concerned there was no improvement of their mechanical industry and no scope for securing additional capital. The highly ingenious and intuitive people who were famous for constructing tanks, wells and agricultural

implements and whose civilisation was of a high order, certainly would have progressed much if the rulers did not care much for plunder and spread of religion than for imparting graceful arts. The universal rule of despotism must certainly have inculcated the habit of hoarding, i.e., burying precious metals deep in the pit.

The rise of the Maharattas, the invasion of the Persians and the decay of the Mogul Empire brought in troubled times and must have strengthened this hoarding habit. In the words of the distinguished historian Colonel Daw "Hindusthan was torn to pieces by factions. All laws, divine and human, were trampled under feet. Instead of one tyrant as in the days of the Empire the country now groans under thousands and the voice of the oppressed multitudes reaches heaven. It would therefore be promoting the cause of justice and humanity to push the petty tyrants from the heights to which their villainies have raised them and to give to the many millions of mankind a Government founded upon the principles of virtue and justice."¹

The East India Company which soon became the *de facto* ruler never pursued a wise currency policy. It helped and stimulated decisively the hoarding habit of the people. The Company's exclusive reliance on the silver rupee instead of encouraging the circulation of paper-money led the people to persist in their unwise habit. Though acute monetary stringency was often felt during the days of its rule the Company did not encourage the use of fiduciary bank paper. Gold was practically driven out of circulation by legal enactments from 1818 and the E. I. Company issued Treasury Notes which in 1856 reached a total of £967,700, in order to ease the monetary stringency.² Throughout the early half of the nineteenth century there was great

¹ See also J. W. Kaye, "Administration of the East India Company," pp. 37 & 38. Kay observes that "industry was paralysed, trade was at a standstill. People buried their money in the ground. It does not a little trouble as wrote one of the Company's Chief Servants to pay 9 per cent. for what money we shall be forced to take up for your account towards providing of goods for the next year and at that rate little can be had, every one rather burying their money than adventuring to trust it out in time of war. And with good reason too was the treasure buried deep in the ground for another of the old Company's servants writes about the same time that upon any occasion of war the king will either have the purses or also purse and head. Nothing was more dangerous in those days than to be the possessor of a little available coin. The Mogul Princes opened their loans at the edge of the scimitar."

² See B. R. Ambedkar, "The Problem of the Rupee," p. 34.

demand for money and business was often at standstill owing to the lack of a suitable circulating medium. The Company accumulated treasure in 40 or 50 treasuries and 40 to 50 thousand sepoy were annually employed in escorting treasure from one district to another. A sound paper-currency would have sufficed for the purpose and the cupidity of the soldiers would not have been excited during the times of the Mutiny by the sight of local treasuries possessing large sums. Thus there was much of brigandage, invasion and misrule and the habit of secret accumulation due to the insecurity of the political disturbances and troubled times is still to be eradicated.

This habit which was generated during the Middle Ages was fostered to a certain extent by the lack of a scientific currency policy in the British period. By denying gold coin to the people and circulating overvalued silver rupees it has only attached undue importance to the gold coin and bullion. Since Sir James Begbie¹ first propounded this theory much prominence has been given to it by the critics of the Government currency policy. This is not the proper place to examine in detail the Government policy which led to the popularisation of the overvalued token currency in preference to full value coins or representative paper money.

Social Causes.

Social causes were tending towards the same goal. The use of gold and silver ornaments is enjoined by social and religious usage. The practice of giving *Stri Dhan* to women in the shape of gold ornaments at the time of marriage is a recognised custom. An ostentatious display of gold by the people tends to confer social prestige and it is not merely the aesthetic taste of the women that can account for the excessive use of gold ornaments. The law of inheritance of the Hindu population of the country debarring their women from receiving any share of landed estates or immovable property generally induces either the father or the husband to bestow gold on these beneficiaries. The joint-family system encourages the same tendency and the husband who is earning generally lavishes much of his savings in gold and silver ornaments for his wife so as to prevent

¹ See his note appended to the Chamberlain Commission's Report, paras. 6 and 10.

the savings from being compounded in the property of the joint-family. Ornaments are now considered as property. So long as the legal rights of women such as inheritance of real estate and property are restricted as at present this method of conferring property on them would not be given up. Without an alteration in the law of inheritance it would be very difficult to check this inordinate use of precious metals as ornaments.

Economic Causes.

The lack of multifarious agencies for looking after savings as in the case of the advanced countries is another contributory cause. An ex-Finance Member of the Government of India admits this contention in the following language: "The average poor man in India has no banking facilities; he is not sufficiently educated to have acquired the Savings Bank habit and until he improves sufficiently by education to appreciate the investment habit or until we can provide him with the necessary banking facilities, silver and gold are practically his only means of banking."¹

If we take the example of the United Kingdom into consideration we find that there are, in addition to sound commercial banks, Trustee Savings Banks, which act as efficient bodies in the garnering of the poor mens' savings. The National Savings Certificate plan organised during the War had a twofold object, that of collecting savings and the far more important one of guiding them into safe and sound channels. Insurance Companies, Trust or Finance Companies and well-organised Stock Exchanges free from speculative tendencies also guide the general public in the choice of their investments, so that a monetary use is made of the spare cash and savings of the people. The problem here also is the utilisation of "the money that lies dormant in endless small hoards." As Sir D. M. Dalal, the President of the Bombay Committee on the rehabilitation of Government Securities, says, "India is full of money and notwithstanding the general idea that it is not available for investment in my opinion it is a question of terms and security."

¹ See Budget Discussion, March, 1921, Indian Legislative Assembly.

Another economic cause responsible for the recent recrudescence of the hoarding habit is the fall in the price of gold bullion and the uncertainty as to whether gold would continue to be cheap, has no doubt led to increased imports of gold into the country.¹ It has already been stated that the import figures of gold during 1922 to 1925 are quite exceptional in nature and that no proper inference can be drawn out of them. With the steady growth of the popularity of fiduciary currency and the investment habit in the country the gold imports for non-monetary purposes will fall and a glance at the recent reports of the Controller of Currency convinces one of the decrease of gold imports into India.

Remedies.

It has already been remarked that the habit of hoarding of spare cash in the form of ornaments which is unreservedly condemned as hoarding must be changed into one of fruitful and productive investment. We must remember in the first place that the cause of ~~this~~ is not a mere blind slavery to the primeval instinct of acquisitiveness. The real objective is prudent provision against famines, pestilence and unforeseen contingencies. When such contingencies do arise these small amounts get dissipated into thin air. The real course is to popularise an investment which possesses in addition to its productive nature all these qualities of the ornaments, perfect safety and easy realisability. The terms of such investment must be clear to all and the collection of interest must also be looked after by a reliable and yet cheap agency. All these aims can be secured by extending investment banks or trust or finance companies in the country and under their persuasion, influence and guidance the tendency to invest would surely receive an impetus. A part of the favourable net balance of payments can be invested every year under their direction in foreign countries. It is essential that a sound banking system capable of assimilating the gold imports and regulating the consequences of gold exports from the country should be organised. Some of the richer agriculturists, middlemen and muffussil traders who have made profits during the war should be taught that banks afford the

¹ See the Report of the Controller of Currency, 1924-25, pp. 6 and 7.

best store of value and relieve them of the risk and trouble of keeping large stocks of precious metals in their house. The advantages of a banking account have to be brought home to them in a vividly striking and appealing manner. Even those who are aware of the advantages of a banking account do not always come forward to keep one. The quick disappearance of mushroom banks which spring up now and then strengthen such disinclination to open a banking account. Hence it is as important that the bigger banks should enlarge their activities as that these small rotten ones should not be allowed to spoil the public confidence. The main problem of the banker is to gather the unorganised capital in the mufusii and individual transfers of money must be tackled by the banking institutions or branches transacting business once or twice a week in those places which cannot afford to maintain a regular branch. The services of the co-operative movement should also be enlisted in this direction. A more vigorous policy on their part in the direction of securing deposits would make them not only independent organisations but would have the effect of combating this pernicious tendency.

Education.

Education is, of course, a *sine quâ non* of this reform. Else the masses cannot easily imbibe the idea that the proper place for their savings is not the person of their womenfolk but the coffers of banks which can use them as the basis of the credit structure and promptly return the same if and whenever the depositor so desires.

The banking habit being mainly a habit is best inculcated in childhood. Mr. Vidyasagar Pandya suggests that "a small penny bank may be attached to certain schools as in England." Such encouragement of practical thrift would be desirable in every way. It is the duty of the bankers to point out that, instead of absorbing precious metals with the available net export surplus agricultural machinery, implements, iron, steel and such other things can be secured which would lessen their dependence on the external markets. If cheap agricultural machinery could by any means be brought to the door of the average cultivator and made available to him by some

form of credit, its effect on the hoarding habit would be twofold. Firstly, it would stir up the placid contentment of the masses and indirectly help that rise in the standard of living which would not fail to act as a sharp spur to economic progress. The second advantage is the cultivator need no longer hold precious metals in the form of jewellery to serve as a kind of pawnable security.

Again the banker has to teach how the efficiency of pooled up money in his hands would be increased by being lent out to others. Internal capital resources would be augmented to a great extent. This is our immediate duty and it would be too early to dream of India as a world's creditor nation. A modest beginning can however be made in this direction.

Vernacular circulars must be issued by each bank stating the principles of banking, the advantages of a banking account and the bankers' own progress from year to year. These will convince them as to the utility of the banks. In England, it is stated, every man has his own solicitor and his own bank. Although our people are rapidly achieving the first part of the ideal much to their own detriment they have not copied the more paying and useful habit. Although it is true that India should have a far larger number of banks and branches than at present still it is not the number of banks that matters so much as the number of people that keep banking accounts. MacLeod says, "the beneficial effects of banking are produced not by the number of banks but by the number of people who keep banking accounts."

Auxiliary Remedies.

Though education in the proper investment of savings and the spread of the banking system are the primary remedies, several auxiliary measures would have to be devised so that by close working of these diverse remedies something might be done to check this unwise and uneconomic habit.

On-Tap Savings Certificates.

The introduction of the "on-tap savings certificate would inculcate the investment habit." A generous response was seen in the case of



the Post Office Cash Certificate which offered liberal terms. Potential capital lying in the muffusil can be gathered by this method but it would practically undermine the popularity of the Postal Cash Certificate.

Cheap and useful manufactured Articles.

It is also well to consider the effects of a rise in the standard of living. The provision of a large number of cheap and useful manufactured articles would lead to brisk buying and selling of commodities and people would make a business use of their spare cash and commodities and gold would be put to a more proper use. If it is spent on productive consumption it tends to improve the earning capacity of the people. This increase of the taxable capacity would confer a double advantage on society. Firstly, the people would be better able to bear further increase of taxation from a steady income arising out of a steadily improving standard of living. Secondly, increased savings on the part of the people would be an advantage to the state.

Agricultural Credit.

The perfection of the agricultural credit machinery forming a part of a general banking system would tend to reduce the so-called hoarding habit. One of the prime objects of such hoarding is to keep something which can be pawned with the local money-lenders.

Changes in Tastes and Fashions.

Economy in the use of the precious metals can be initiated to a certain extent by changes in tastes and fashions. Pearls and diamonds can be substituted for gold and silver and if the women of the upper classes devote a considerable share of their income to the new objects this love of ornament would permeate the other sections of society. If the real purchasing power of the people expands recourse to precious metals for the mere love of ornament might be weakened. The newer objects selected should be portable and possess great value in small bulk. These would still be unproductive no doubt and cannot be recommended as a remedy for poverty stricken people. These require productive investments.

Insurance Habit.

The development of the habit of insurance on the part of the people is also essential to weaken the tendency to accumulate precious metals as stores of value. There is no insurance tradition as it were in this country. There are very few insurance companies in India and life insurance per head of population in the country is Re. 1-4-0.

Attracting and encouraging Investments.

More facilities for purchasing such investments as sterling securities should be created in India. This can never be done on any adequate scale so long as there are only a few forms of investment for the Indian investors. The Government of India should enable the people to hold Indian sterling loans floated in London and interest should be paid at the Government District Treasuries or branches of the Imperial Bank of India. If this is not forthcoming banks like the Imperial Bank of India must sell Government securities on behalf of the general public besides their own constituents at a fixed charge and thus facilitate the investment habit. The Indian banks are holders of Government securities on a large scale and a healthy market in the Government securities means a great protection to them. This they can secure by granting remittance facilities from one local Head Office to another on the security of Government paper. It should be possible to conduct more easily the formalities in connection with the transfer of securities.

The Indian Hoarder is mistaken but not perverse.

Under proper guidance the Indian people would not feel shy of investment in industrial companies. The investment habit is on the increase and taking the 1915-25 period there was considerable investment in industrial companies. The Indian people have freely invested in the Rupee loans and the P. O. cash certificates. The number of Bank depositors has also increased largely during this period. During the same period Jute Mill shares have freely changed hands and 60 to 70 per cent. of the shares are now supposed to be owned by Indians. The Indian capitalists of Bombay are now coming forward to invest freely

in bonds of the Brazilian Government. A portion of the recent Sterling loan was also subscribed by Indians here and the Indian capitalists in England are freely investing in Sterling loans of the Government of India. The policy of the Government of India should be to place greater reliance on Rupee loans so long as they can be floated in the money market. This by itself would go a long way in increasing the investment habit on the part of the people.

Alteration in the Law of Inheritance.

Much more has to be done besides the usual means of attracting and encouraging popular investments. The treatment of the evil calls for an alteration in the law of inheritance so as to enable the Indian people to provide for their female dependents without recourse to the barren method of hoarding precious metals. It is significant that our women are conscious of this fact and unless something is done in this direction there would still be a considerable portion of the population which continues to keep its savings in the form of idle cash.

Few thoughtless Remedies.

Besides the commonly suggested remedies education and provision of banking facilities, I have mentioned several useful methods which go more to the root of the matter and impel people to make a truly economic use of rational savings. It is also essential to correct the mistaken conceptions of few specialists who propose to tackle this evil by purposeless or ineffective solutions. The Government guarantee of bank deposits can also be suggested as an antidote to the hoarding habit, but unfortunately it is not a step of unmixed or assured good as the resultant harm may possibly be greater than the gain. It is undoubtedly true that it would increase the deposit habit by placing the banks above the risk of panicky runs. But the corresponding disadvantage should not be forgotten or overlooked. The strong are made to pay for the weak and loose and careless banking methods would be fostered. The plan of mutual guarantee of bank deposits exists in some of the States of the U. S. A. But in the State of Oklahoma at least it failed miserably. The conservative bankers would be at a disadvantage and it would be better to try to prevent

failures rather than concentrate upon payment after failure. Prevention is always better than cure.

Another doubtful remedy is the starving of currency which has been advocated mainly in order to dissipate the hoards and draw silver coins out of the hiding places. But this undoubtedly would lead to high discount rates during the period of rarification of currency, and there is no guarantee that the advantages will not be outweighed by the disadvantages. The return of money from the hoards and their sound investment in productive enterprises depend of necessity upon the adoption of a simple, intelligible and thereby thoroughly reliable monetary system. A change in the currency gauge is essential to get to close quarters with this problem. A gold currency would increase this habit in the first instance by making the smaller gold coins easily available. But in the long run it will release gold out of the hoards and check the propensity to hoard gold bullion, and if gold currency is freely circulating from hand to hand even gold coin hoards would tend to disappear. The educational influence of gold currency cannot be denied. This is only a corollary of the well-known psychological truth which considers that "if once a thing becomes common people do not want to hoard it." Too much reliance cannot be placed on this argument. Gold coins would not form a substantial portion of the currency transactions as even the smallest of them would be too large for the daily transactions of the people. The conditions for the maintenance of a free gold market have already been outlined and this is essential for people to be sure of securing the required gold.

Final Conclusion.

Even if all the lines of attack indicated above were adopted the predilection of the people for holding precious metals would still continue for some time as no civilised country has been altogether free from this habit. In France, the recent attempt of the Bank of France to purchase gold by paper francs brought out £75 mil. of gold and gold coin in the very first week. But until the circulation of wealth is increased in this country and more of productive channels found there is no use of these stored-up treasures. However assiduously the campaign may be conducted against this habit still it is

impossible to envisage any practical date when it can be stated that the people are completely free from this unwise propensity. The process of changing this habit in India must perforce be a slow one. The remarkable degree to which the use of notes has developed in this country during the last few years makes one confident of ultimate success. But the increase of the deposits of banking institutions depends absolutely on the development of the banking habit and without banking resources a successful economic life would be impossible. The dominant need of India to-day is fresh credit for productive purposes, even though this means more money in circulation and more deposits in banks. We may soon have some need to exercise some restraint in the exportation of our capital resources abroad if we fail to develop enough capital resources for our internal productive purposes.

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CHAPTER XV.

BANKING MANAGEMENT.

The personnel of the Bank Executive—Directors, Managers and Shareholders—Japan's training—The example of the U. Kingdom—A Banker's Association—Its aims—Which example to follow?—The work of the American Bankers' Association—One such Association needed—Suggestions—Improved form of balance-sheet—Its periodical publication—Pamphlets to educate customers—The management of the system by the C. Bank—Stable price-level—Credit Control by bank rate—No reserve discount policy but price-stabilisation discount policy—Universal gold standard with stable value of gold—Scarcity of gold and attempts to solve it—Perfection of the indices to be employed in the price-stabilisation discount policy.

The foundation of a joint-stock bank's success is solely due to the body of directors, the managers and the trained staff of banking officers who work under the immediate orders of their superiors. In India the banking system is generally under the control of the executive officers who are styled "Managers" and in some cases "Managing directors" if they happen to be directors also at the same time. The bank share is not a popular means of investment as yet with our public and it would not be far from the truth if it were to be stated that bank shares are not usually in the hands of small middle-class investors as in the case of the United Kingdom. The following figures published in Walter Leaf's "Banking" are very instructive.

Name of the Bank.	Paid-up capital.	No. of Holdings.	Amount of Average Holdings.	
			Nominal.	In market value.
	£		£	£
Baray's ...	15,592,372	51011	306	790
Lloyd's ...	14,322,956	55668	258	774
Midland ...	11,976,890	57250	209	750
National Provincial ...	9,479,416	41603	225	684
Westminster ...	9,051,718	69882	130	592 } 192 } ²

¹ The callable and reserve liability which is generally attached to the Indian bank shares and their large denominations have precluded the smaller capitalists from securing these shares. In "Overseas and Foreign Banking" the case is often otherwise. The shares are of manageable amount and the tendency is to reduce the uncalled or reserve liability.

² 20 £ shares, £5 paid. ³ £1 shares fully paid.

It has already been stated that neither the shareholders nor the directors of the Jt.-St. Banks are aware of their proper duties. The directors do not consider themselves as "trustees of the depositors also" and they have never opposed the reduction of the dividends nor have they suggested to the shareholders the foregoing of dividend whenever they considered either of these policies in the interests of the depositors.

While the Board of Directors meets occasionally and works through Select Committees for dealing with special aspects of business, the daily management of the work of the Bank is solely in the hands of the manager or the managing director who is solely responsible for the successful working of the bank and for the superintendence of the bank officers. Although our present situation as regards the executive officers is not so deplorably hopeless as in the past still there is a lack of trained bank managers possessing complete knowledge of banking theory and an adequate amount of practical experience. The Indian Industrial Commission observes—"that there is a lack of trained bank employees owing to the absence in the past of facilities for commercial education and of any regular system of training Indians in banking work while the countryfolk are not alive as to the advantages of organised banking." The Lahore Committee says "that there is a strong need of promoting a knowledge of banking systems among the people and it emphasises the necessity of training people in banking work. Pundit Madan Mohan Malaviya says—"the Government of India should take definite steps to impart the best instruction to young Indians in banking through the best teachers it can appoint." According to him one of the advantages of a State Bank should be the providing of facilities for training Indians in banking work.

Pandit Malviya instances the marvellous development of banking in Japan as chiefly due to the training of its people in the banking business. "At the time of the Restoration in 1868 there was complete ignorance of the methods of finance or of banking or of joint-stock companies. National economy and national finance were both in a perilous condition." To remedy this condition a Commission under the Presidency of Prince Ito was sent abroad to study the working of the financial institutions of the progressive

Western countries. This Commission studied the conditions prevailing in Europe and were much impressed by Walter Bagehot's effective reasoning for independent banking reserves. On its recommendation national banks modelled on the American National Banking System were organised and finding out the defects of the system during the course of a ten years' trial the Imperial Bank of Japan was established in 1882 as the Central Bank looking after the banking system of the country. At the present time separate banking institutions deal with the different kinds of banking business. *En passant* it might also be pointed out that monetary difficulties including currency depreciation which were so acutely felt during the Shogun regime disappeared as a result of a foreign loan and the bank notes issued by the Central Bank. Thus Japan's example clearly proves that monetary reconstruction is nothing but banking reorganisation.

The prime requisite for possessing a good banking system is to have a number of persons who have had a good grounding in the theory of banking with a fair amount of practical knowledge in some of the different banking systems of the foreign countries. Baron Snibusawa says that the success of the banking system in Japan was due to such preliminary training in banking.¹ Shirras echoes the same opinion when he says "Just as trained teachers are of first importance to Indian education at the present time so are trained officers in sufficient numbers to Indian banking."² At another place he says "without trained leaders the banking army will never win a victory and we shall have to depend almost entirely on that hard-working body of men who bring to the East the banking wisdom of the West." He recommends that our Universities and the colleges working in

¹ Before concluding this essay the writer cannot refrain from expressing his profound satisfaction at the fact that the small spring of banking business which had been so insignificant at the time of the Restoration has by a gradual process of accretion become a broad and navigable river as it is now and his conviction is that this is the result of having followed the example of European and American nations. The Japanese are very grateful for the valuable services of Mr. A. A. Shand, now a director of the Paris Bank, London, who came to Japan at the invitation of the Issue Department in 1872, acted as the adviser in banking to that Department, wrote valuable books on banking, instructed young Japanese in that line and thus paved the way for the development of banking business in that country. See Count Okuma, "Fifty Years of New Japan," Vol. I, p. 352.

² G. F. Shirras, "Indian Finance and Banking," p. 432.



greater co-operation with banks should do more than they have done in the past."¹

Even in the United Kingdom the heads of the great banking establishments are not satisfied with the quality of men who are being attracted to the bank offices. Although there is a banking career existing there attempts are constantly made to attract the best possible men to the banking business. As Walter Leaf says, the banking career must be placed in a light so as to be on a par with "the most lucrative professions existing now."²

The late Lord Faber, the President of the County Bankers' Association, said that "the banking career should be placed on a footing by which it will compare favourably with any of the learned or professional careers in the country." His suggestion was that "youths already in banking service should be given scholarship to enable them to take a full three years' University course in commerce as part of their career."³

In future increasing attention has to be paid by the Indian banks while recruiting their Indian element in the banking staff. It should be remembered that "the English banker in India is not always all that can be desired of a banker. He is lacking as much as the Indian banker in that superior realisation of the nature and object of banking. It is an open secret in the money market that sometimes X the manager of the bank A speculates in the name of his personal assistant in the shares of the company and how Y the Secretary of the bank B gambles in cotton. That neither X or Y is easily found out speaks indeed highly for the perfection of his education in so conducting his operations as to leave hardly any evidence that could be accepted in a court of law. Such sort of men cannot be the requisite models for our Indian officers to copy."⁴

As we find that even the European bank official is not the ideal one, for, there is a lack of touch with the feeling of the people and

¹ *Ibid*, p. 420.

² See Walter Leaf's Presidential Speech at the Annual Meeting of the Parr's Bank, 1919.

³ See Lord Faber's Presidential Speech at the Annual Dinner of the Institute of Bankers, 1919. Therein he relates how American Banks recruit their clerical force from the public schools of New York. See also L. M. Minty, "English and American Banking Methods."

⁴ See Tannan and Shah, "Indian Banking and Currency Problems," p. 241.

an insufficient appreciation on their part of the vital interests of the country ¹ we should lose no time in preparing and training men of our own country. The sooner we rectify this defect the easier will be the task of obtaining for India a financial ascendancy to which she is justly entitled by virtue of her natural resources and great financial strength.

The formation of debating societies, the equipment of an up-to-date library in banking offices, the granting of scholarships to bank officers to proceed to Europe and America to learn the practice and methods of commercial and co-operative banks and the transacting of foreign exchange business and the contribution of articles by senior officers of banks in banking journals to give the benefit of their experience to the junior officers are some of the measures which have to be undertaken by the banks to improve the knowledge of their staff. It is false economy to rely on an incompetent and insufficient staff. ²

A Bankers' Association.

The friendly intimacy and comradeship engendered by the presence of several banks in the Bankers' Clearing House has borne fruit in the various associations that have been started in all countries where

¹ The most important thing that the modern banks would have to note is that their European Officers are trained only to evaluate the standard shares of Joint-stock Companies or Government Promissory notes quoted on the stock exchange or other negotiable securities. As this would not be available in the interior they would be unable to render any service to banks in this direction. If internal trade is to be adequately financed it can only be forthcoming as a result of discounting promissory notes of the mufussil wholesale dealers. As such negotiable securities are unattainable in this country the dependence on an expert European staff for mufussil banking is absolutely unwise.

² This is what most of the Loan Offices in Bengal do at present. Even the directors owe allegiance to several professions besides banking. The Doctor-Director or the Engineer-Director or the Lawyer-Director can hardly do justice to so many irons in the fire. The improving of book-keeping and business methods is also essential and instead of depending on one or two clerks to perform the sole business there should be proper division of labour and expeditious service rendered to the depositors and customers. Encouragement of short-term deposits, discounting of bills of exchange, cheques, and Promissory notes backed by two businessmen, and provision for cheap remittance to other places would have to be provided and these cannot be done by the single clerk—the maid of all service as he can be termed of Loan Banks in the mofussil. A new orientation which is so essential for the smaller banks to adapt themselves with the changing times cannot be brought about in the absence of managers and directors and officers who know banking and whole-heartedly devote themselves to it, eschewing also other avocations.

banking progress has reached an advanced stage. The credit of starting the first Institute of Bankers belongs to Scotland. It was started in 1875 and to-day it has on its rolls about 4,022 members. The Institute of Bankers in England was started in 1879 and it has now a membership of 20,984. The Institute of Bankers in Ireland was started in 1898 and it has on its rolls about 800 members. These Institutes consist of the officials of the Banks in the country. Strong bankers' institutes have been started in Canada, Australia and South Africa on the model of the English Institutes. The American Banking Institute has 160 chapters in all parts of the country and about 54,390 members are engaged in some department or other of banking business. These institutes have carried further the idea of the bankers' associations which aim at providing a common platform and a meeting place for the various banks to assemble and discuss their common topics. In Germany there is a central federation of banks and bankers to discuss banking topics.¹ In America there is held every year an annual convention of the American Bankers' Association and all interesting developments and new departures in banking methods are keenly discussed.

Other Aims.

The suitability of rates charged by the various banks and their co-operative adjustment so as to eliminate competition and rivalry is one of the chief objects of these associations. Measures for banking reform and legislative proposals affecting the banks as well as their suitability or non-suitability to domestic conditions are fully discussed. A knowledge of the science and art of banking is imparted to the banking officers by means of lectures, classes, libraries, debating

¹ Some of the resolutions placed at the recent banking Congress held at Berlin urge the reduction of the administrative costs of the banks. Another considers the numbers of banks in Germany as too great. Another requires the restoration of legislation concerning banking secrecy. Another points out that bank credit should be granted on first class security only for economically productive purposes. Besides these resolutions several interesting papers concerning the economic situation of Germany have been read at the Congress.

society and reading rooms provided by these associations. Well-conducted magazines discussing foreign banking methods and improved innovations are the usual official organs of these bodies.

Which example to follow ?

Now that an Institute of Bankers has been started in this country it is essential for it to copy the progressive American model, viz., that of the Canadian Bankers' Association or the American Bankers' Association of the United States of America. These go a step further and perform the following functions in addition to the work of propagating sound banking methods and instilling the ideas of common fraternity in the minds of the bank officials. The Canadian Bankers' Association looks after the note circulation of the various banks. It holds periodical examinations by means of its inspectors of the banks' position as regards its note circulation and reserve. It undertakes the work of liquidating all failed banks and the Canadian banking law compels every recognised bank to become a member of the Association. Its headquarters are in Montreal in the Bank of Montreal building and its executive officer is the Secretary-Treasurer. The expenses incurred by the Association on account of a suspended bank are of course a charge against the assets of the bank. The Clearing Houses in the Dominion are subject to regulation by this Association. It undertakes educational work by providing for lectures, competitive paper examinations, etc. The Journal of the Canadian Bankers' Association is a monthly publication serving as a great educative factor among the bank employees.¹

The American Bankers' Association takes a keen interest in agricultural education. It advances money for buying a cow and the loan is to be paid out of profits arising out of the sale of its yield and it is stated that one boy obtained a profit of \$100 out of this method of advance. It awards prizes and gathers all adult farmers at its luncheons affording them an opportunity to discuss their own affairs. Canada is following suit and adults as well as children are taking great enthusiasm in agricultural practice. The Agricultural

¹ See J. F. Johnson, "The Canadian Banking System."



Commission of the American Bankers' Association is advocating a "national drive" in the providing of new roads and pushing sanitary improvements by proposing to vote \$200,000,000 for this purpose. All this is to make country life prosperous, and with the peasants' prosperity in the ascending scale the bankers would be obtaining greater deposits and more working capital for their business. The protective department of the American Bankers' Association has successfully prevented the criminal depredations against banks.

Some Notable Results.

It is true that even in the United Kingdom the idea of fraternal relationship which has been developed by the bankers' associations has permeated the minds of bank officials in England who have formed themselves into the Bank Officers' Guild. It consists of all bank officers and its object is to protect the interests of its members and to improve the knowledge of the junior members. To establish closer contact between the superior officers and the younger members of the staff is another useful object of these guilds. Banking has been recognised as a distinct profession with its own policies and traditions. The wider interests and responsibilities of the bank are clearly grasped so that the old narrow profit-grabbing motive is slowly yielding to the higher ideals of national development and material progress of the community as a whole. Banks are well conducted and a spirit of noble emulation actuates all the leading concerns. National credit is guarded carefully and as a result of the better understanding of the true principles of credit, currency and capital serious panics have become an occurrence of the past. Crises still occur but the rude shocks of sudden panic are prevented by the excellent management of the banks. This is solely due to the class consciousness created by the

¹ See Minty, "English Banking Methods."

Each large bank has one "internal guild" and negotiations between the staffs and Boards of big Banks are carried through the mediation of internal guilds. There is a joint council of these guilds which secures similar conditions of service in the different banks. "The Bank Officers' Guild" which partakes more of the nature of a common Trade Union is practically a moribund institution and it is not a thoroughly representative body as yet.

Bankers' Association and the better understanding of the principles of banking profession which is only an indirect result of the educational propaganda of these bankers' institutes and associations.

One such Association needed.

If such are the manifold advantages that can be realised from the successful functioning of a really progressive Bankers' Association no time should be lost in starting such a progressive institution in this country. The Eastern Exchange Banks have an association of their own wherein are represented some Indian Joint-Stock Banks conducting foreign exchange business. The indigenous bankers have their own associations but there is no common platform or meeting ground for all bankers, the old and the new, the immigrant and the swadeshi, the expert and the amateur, to come into contact with one another. As the Lahore Advisory Committee to the Indian Industrial Commission says, "there is no association to look after the general policy of banking development as a whole."

Suggestions.

It is highly imperative that the newly created Bankers' Institute or Association should bear the following points in mind. It should not only endeavour to be thoroughly representative of all banking interests but meet frequently so that it may afford scope for the free interchange of knowledge on matters that concern them all and such procedure will not fail to benefit all the banks individually and the Indian banking system as a whole.

Besides undertaking the dissemination of sound ideas the suggestion of useful reforms in banking practice and law and the spread of profitable knowledge, it must be its sole object to serve as an educational force at work among the bank officers. It has to undertake a course of lectures corresponding to the "Gilbart Lectures" of the Bankers' Institute of London to tackle problems of Indian banking and arrange for the delivery of usual lectures to enable bank clerks to grasp the theory, practice and law of banking. Its monthly magazine entitled the Indian Bankers' Magazine

must devote itself to all recent improvements of foreign banking methods and discuss the feasibility of applying them to Indian conditions. This is the best practicable measure that can be undertaken at present to improve the wisdom and knowledge of our bank officials. Incidentally it can do much in the collecting of useful banking statistics that might be of help to any future economist and historian. The periodical publication of balance-sheets can also be arranged for. The successful functioning of this Institute of Indian Bankers would undoubtedly lead to a unity of policy, the prevalence of common sentiment among the several banks, the enunciation of sound and high standards of banking and would soon create a spirit of *entente cordiale* between the Indian-managed and the European-managed banks. It must co-operate with other educational institutions in the country with the object of creating wider knowledge of modern business methods, thus initiating the march for secured orderly national progress.

An improved form of Balance-Sheet common to all Banks.

We have now reached a stage at which it is easy to realise that banking success depends greatly on expert executive management. But the question of further progress greatly depends on the amount of confidence it can inspire in the minds of the public. Many of the Indian banking institutions have not as yet realised the tremendous advantages that would accrue to them by the 'light' of publicity being thrown on their affairs. If only they exhibit facts and figures concerning their rapid growth much can be done to attract the deposits of the people.¹ The present balance-sheets of our banks are scarcely intelligible to the ordinary reader. They have not adopted a telling balance-sheet the figures of which are replete with information.²

¹ These facts should not be considered in the light of institutional secrets. A systematic publication of them by the advertising department of the banks would enable the people to trust the banker and instead of locking up their funds in unproductive enterprises the people would willingly deposit their money in the banks.

² The balance-sheet of the Central Bank of India published on 31st December, 1923, is up to the mark in this respect and the graph illustrating the yearly progress is to be commended. All other joint-stock banks should follow its lead in this matter. Since these lines were written the Dawson's Bank, Ltd., has been publishing a balance-sheet that any man can easily understand.

Unless this is done the outsider will not be attracted to the bank, much less will he care to deposit his savings therein.

A periodical publication of balance-sheets of the type recommended in the chapter on banking legislation will contribute much towards the enlightenment of the people as regards the condition of the bank and the valuable searchlight of public criticism can probe deep into the parts and produce much beneficial effects and bring about a substantial improvement in the bank's position. It is a matter of gratification to record that the English joint-stock Banks have realised the necessity of publishing a monthly balance-sheet according to a set type and the Lloyd's Bank, one of the Big Five, has been publishing a more informative balance-sheet than the standard advocated in the Cunliffe Committee's Report.

Again a comparison of these uniform statements of different banks published simultaneously would afford a reliable basis of criticism and these publications serve as an excellent means of self-education for the banks. This mutual criticism of the banks might result in a uniform policy of business management.

So it is highly desirable that all the banks should send in their monthly statements to the Banker's Journal which would be started as early as possible. In its absence they ought to be published in the local gazettes. No reform is more desirable than a uniform balance-sheet drawn up on identical lines for all banks and this should conform to the type recommended elsewhere in another chapter or it should be arrived at by a common agreement amongst the banks themselves.

Pamphlets to educate the Customers.

The general policy of the banks must be directed not only towards giving full information to the customers as to the state of the volume and nature of the commercial credit granted by it but it should be its aim to issue brief surveys of finance¹ and industry to all its customers just as the Lloyd's Bank or the Barclay's Bank and other big joint-stock banks of New York do. Our banks should issue private circulars in vernacular to its business customers and branches, informing

¹ The Central Bank of India has again taken the lead in this matter. It issues monthly notes of educative interest to the staff so that a more efficient and expeditious service might be rendered to the public. These notes were first issued in December, 1922.

them briefly as to the actual condition that prevails at the leading industrial and produce markets and have short and pertinent articles on current topics of finance. This is one of the most potent means to help the branch managers to keep abreast of the times.

When these bank circulars reach the rural masses it is quite possible that they would realise the utility of banking institutions and cultivate business relations with them.

The progressive policy of the American banks is worth imitation. The pamphlets of some of the American Banks educate the customers as regards the best methods of accounting so as to reduce business death-rate. Some of the American banks have produced a crop of bankers and bankmen who are prepared to speak to the clubs and associations and impart sound economic and banking knowledge. These are doing much to make the farmers consider farming as a business proposition and some of the American banks undertake to keep the farmers' books and this is one effective method of attracting customers to the bank. American Banks pay much attention to propaganda and publicity. They never lose an opportunity to remind the people of their utility and bring their banks before the public by formal address at works at the dinner hour, and a judicious use is made of advertisement through the press and picture houses, by the issue of calendars and through publications. They always work on the principle that "the bank has to come to the people and not wait for the people to come to it."

It is the duty of the Indian Joint-Stock Banks to adjust themselves to the changing economic conditions. It has been pointed out elsewhere that dependence on European banking interests and purely commercial banking as we witness in present-day conditions should be changed. With the increase of banking capital and expansion of Indian trade, Indian banks should strive to make their economic position self-contained. They must strive to accomplish more in the future by the perfection of their executive management, use of time-saving machines which relieve them of personal expenditure of time and effort, systematic business organisation and familiarise the people with modern credit instruments such as bills of exchange which are of very valuable service in securing liquidity of financial position in trade and industry. They must attempt to develop a highly perfected

credit organisation and through credit control relative price stabilisation can be secured so that a stable and successful economic life can be ensured. Since the time when it has been disproved that credit stabilisation is not the "same thing as price-stabilisation" monetary reformers have been concentrating their attention on price stabilisation and propose to achieve it by the creation of a Central Bank of Issue and delegating to it the task of controlling credit with the avowed intention and sole object of conferring relative price stability on the country.

The Utility of the Central Banking System.

Before the recent war the utility of the centralised banking system was only half-understood and the efficacy of even the reserve discount policy was not realised by all countries. It was after mature deliberation that the United States of America discarded the decentralised banking system in favour of the centralised banking system but she managed to secure the real spirit of the system without the existence of a Central Bank itself. England, the European continental countries, Japan and the U. S. A. alone possessed this system and as a result of war-time experience not only has the centralised banking system been developed in some of the self-governing Dominions of the British Empire but also in a large number of the South American states, in the Austro-Hungarian succession states and the newly created Baltic states.¹

It is true that in 1923² the Canadian Federal Parliament failed to enforce the idea of the centralised banking system on the existing banking institutions of the country. But it must be remembered that the Canadian Chartered Banks, though they consent to an effective supervision by the state, do not generally sacrifice their independence and carry out the behests of the Government.³

¹ Memorandum on Central Banks by the League of Nations, 1924 Issue, p. 8.

² In 1923 the charters of the Chartered Bank of Canada were renewed for another ten years. The Minister of Finance, who usually controls the central gold reserve of the country, tried his best to convince the banks that a central bank would make an effective use of gold reserve of the country but his suggestions were vetoed.

³ The refusal of the Canadian Banks to lend money at prescribed rates to the credit societies forced the Government to pass the Provincial Savings Act of 1920, authorising the Provincial Government to borrow money from private persons for the express purpose of granting loans to the credit societies.



The events that led to the adoption of the Central Banking system in the Union of South Africa, the Dominion of Australia and Italy and Soviet Russia need not be recounted here. In almost all countries the Central Banks combine the issuing of credit and Treasury functions in their hands. The war-time and post-war experience shows that a proper co-ordination of the financial institutions, a really effective and unified control over financial operations, a national bank-note currency which is convenient and elastic at the same time, steady monetary conditions over long periods and a rational control over the inflationary tendencies of bank credit and speculative commitments of the public on the stock exchange, can never be obtained in the absence of a Central Bank. Hence the recommendation of the Brussels International Financial Conference for the founding of a Central Bank of Issue in all countries which do not possess one such institution already has¹ ample theoretical justification for it.

But the modern currency reformers do not desire to restore the Central Bank of Issue back to the inactive but honourable role of a mere 'bank to the other banks' or 'a reserve bank' usually out of the money market but watching it with a providential eye from its Olympic heights. These reformers seek to stabilise prices and in order to attain this ideal the pre-war aloofness from the money market is no longer advocated. The Central Bank of Issue in conjunction with the Treasury should aspire to regulate credit and currency in such a manner as to secure a stable standard of value. The old reserve discount policy or the policy of creating productive credit is to be discarded for the price-stabilisation discount policy.

This idea of stabilising prices became a topic of international discussion just prior to the war and Prof. Fisher's plan obtained approval of the leading economists in America and Japan.² But the relative stability of the value of money over the long period of the XIXth century³ was considered as "part of the social fabric" and even

¹ See the XIV Resolution of the Committee on Currency and Exchange, Brussels International Financial Conference.

² See "Stabilising the Dollar," pp. 294-296.

³ "Approximately the same level of prices ruled in or about the years, 1826, 1841, 1855, 1862, 1867, 1871 and 1915. Prices were also level in the years 1844, 1881 and 1914." See Keynes, "Tract on Monetary Reform," or W. T. Layton, "Introduction to the Study of Prices."

economists advocated a policy of *laissez-faire* in the field of money. As fluctuations in the value of money were limited to a small range¹ no great enthusiasm for currency reform could be evoked by Prof. Fisher's proposal.

The 'economic earthquake' caused by rising prices during and after the war once more brought this problem to the forefront of economic discussion. This time it was not 'academic amateurs' or 'human book-worms' that started the discussion but men of business, politicians and financiers took keen interest in this matter. All these people realise that "they can no longer afford to leave the price-level to the category of which the distinguishing characteristics are possessed in different degrees by the weather, the birth-rate and the constitution—matters which are settled by natural causes or are the resultant of the separate action of many individuals acting independently or require a revolution to change them." In America they have recently started the National Monetary Association to discuss measures to attain a stable price-level in the United States of America. The Pollock Foundation for Economic Research undertakes a study of events resulting out of monetary measures. The European countries are not lagging behind. Profs. Cassel and Wicksel of Sweden, Prof. Charles Gide of France, Profs. Pigou, Keynes and Mr. R. G. Hawtrey of England, Prof. V. Stuart of Norway and several other distinguished economists are keenly discussing the problem of stabilisation of prices. Before the Brussels Conference as well as the Genoa International Conference² this question was uppermost in the minds of the delegates and experts that took part in the discussion.

The primary advantages or "happy result" of a comparative stabilisation of prices is the stabilisation of the labour market and the maintenance of a steady output of industry leading to the social well-being of all classes in the community. It has often been thought that a steady price-level connotes stagnation of industry; a rising price level denotes stimulation of trade and business expansion and a falling price-level spells ruination to the business people. Beyond a

¹ Even during the Napoleonic Wars and the period immediately succeeding them the extreme fluctuations of English prices within a single year was 22%. See Keynes, "Tract on Monetary Reform," p. 2.

² See the First Resolution of the Financial Conference.

certain degree a continuous fall in the price-level renders the production of commodities particularly those of a more durable kind such as construction goods an economic impossibility. Though the price-level exerts a certain amount of influence on businessmen yet the inner springs that control the economic motivation on the part of the businessmen lies inherently in their business talents and acumen rather than in any outside factor like prices. As W. T. Layton puts it, "national productivity depends much more on the advance of science, discovery and on the training, education and organisation of labour than on the rise and fall of prices." He instances the progress in metal industries as Iron and Steel during periods of depressed prices.

There is almost a consensus of opinion that rising prices are to be preferred to the falling ones. The businessmen² and the bankers are emphatic in their declarations for a regime of rising prices. Rising prices mean rising rates of interest and increasing profits. Rising prices expand productivity and furnish scope towards the expansion of bank credit. Businessmen have to make fixed payments as wages and interest on borrowed capital and hence they make less real payments than before. This improves their position and inspires confidence in increased activity. The greater activity of a few successful businessmen has a psychological influence on the other industrialists and tends to produce an all-round expansion of industry. On the other side the wage-earners and creditors who get fixed income suffer.

Several of the economists have argued on the injuries resulting out of regime of rising prices and do not like the 'illusory prosperity' of such periods of feverish activity. Dr. Marshall has shown that the benefits of rising prices are doubtful and he remarks that "one wants very much stronger statistical evidence than one yet has to prove that a fall of prices diminishes perceptibly and in the long run, the total productiveness of industry." Dr. Lechfeldt³ remarks that "depression of prices, interest and profits are consistent with

¹ See T. Veblen, "Absentee Ownership," p. 129.

² So long as the slowly falling prices confer large buying power even the businessmen do not suffer. "This is often ignored by those affected," says H. Withers, "Money," p. 61.

³ See R. Lechfeldt, "Restoration of World's Currencies," p. 124.

prosperity for the employee would get more and the employer less" and this is not a bad thing in these days of unequal distribution of wealth which is at the bottom of all socialism, syndicalism and other "isms" which aim at the express removal of this inequality. The improvement of industrial technique, the enforcing of rigorous attention towards details, the weeding out of the less capable managers,¹ the centralisation of economic power in the hands of the competent few and the enforcement of caution on the part of the investors can result out of a depression and a period of low prices.² A boom in prices and consequent industrial production is not at all favourable either to the producers or the labourers or the consumers. As Prof. Mitchell puts it, "prosperity is less favourable, not for lack of funds but for lack of time and attention."³ Several other economists such as Dr. F. Simiand, Prof. A. Aflaton and Prof. D. H. Robertson⁴ have clearly shown that in the period of a boom in prices the actual production or output of the workers falls. This has been the case in the coal industry, iron mines and the dock labour.

The pre-war economic ideal as regards the desirable level of prices can be best expressed in the pregnant language of Dr. Marshall. "Under an ideal currency system prices should fall at such a rate that fixed-salaried men should secure a fair proportion of man's increasing control over his material improvements." It is now no longer fashionable to consider rising prices as a "tonic," stimulant or 'rise in temperature,' speeding up activity. It is not germane to this topic to discuss the influence of changes in prices on the industrialists, the wage-earners, and the fixed-salaried class or on investors and the creditor or debtor classes. While this topic has been discussed in detail in the past sufficient attention has not been drawn to the advantages of a relatively stable price-level.⁵ There is

¹ See Prof. A. W. Flux, "Economic Principles," Ch. XIII.

² See Dr. Marshall's Evidence before the Gold and Silver Commission, Q 3816, *et seq.*

³ See W. C. Mitchell, "Business Cycles," pp. 597 to 599.

⁴ See his "Money," p. 123, *et seq.* Although he gives this example, on the whole he is of opinion that "a gently rising price-level may produce the best attainable results not only for the producers but for the community as a whole."

⁵ It is not absolute rigid fixity of prices that is meant by a policy of price stabilisation. It aims at the realisation of a flexible system under which sudden changes in price-level are prevented by accurate, far-sighted knowledge of demand and control over production in accordance with demand. The aim is to prevent changes in prices but to put an end

nothing in a steady price-level which is inherently antagonistic to healthy industrial expansion. The stability of prices acts as a healthy check on the undue expansion and reckless promotion of worthless undertakings which are too often undertaken during the boom days of record prices. As long as the businessmen succeed in gathering "windfall profits" out of unexpected rise of prices, they become the target of attack and various remedies such as "subsidies, price and rent fixing, profiteer-hunting and excess profits duties" are resorted to for transferring a large part of these "windfall profits" to the state and through the state to the community in the long run. Steady prices mean 'normal profits' other things being equal. Even the bitterest enemies of "capitalism" admit the necessity of proper payment to capital, for without capital, society cannot hope to live long; labour must perish and production would fall to a low ebb.

Another advantage of stability of prices lies in the tendency to eliminate the piling up of huge stocks which ultimately results in a glut as consumers cannot respond quickly to this abnormal rate of production. The stabilisation of prices naturally brings about a slow but steady expansion of industry which would not only maximise the output in the long run but guarantee a steady level of employment to the wage-earners. Rising prices yield profits out of their own accord and the temptation to pocket profits is so strong that competing businessmen rival each other in expanding their business leading to better employment and overtime work for the labourers. But when the inevitable trade slump appears, half-time work and dismissal are the undesirable consequences facing the labourers.

It is not industry alone that would be benefited. The existence of the investing classes of the society, namely, the holders of mortgages, bonds, debentures and preference shares would be at stake if prices were to abruptly alter from day to day. Stability of prices

to evils arising out of fluctuations. Enough flexibility should exist to allow for variations in the general prices, changes in the cost of production and shifts in demand." See p. 6, "Stabilisation of Commodity Prices"—Volume of the Annals of the "American Academy of Political and Social Science," edited by C. P. White, September, 1928. The same conception is also expressed by H. Withers when he says "we want prices to rise or fall as little as is reasonably possible and stability in buying power is a quality that is much to be desired from our money."

or the value of money would give distinct encouragement to the investing class to pile up large fortunes and as Prof. Keynes says, "the investment system has made possible all the material triumphs which are now taken for granted.....The morals, the politics, the literature and the religion of the age joined in a grand conspiracy for the promotion of saving. God and mammon were reconciled. Peace on earth was established. A new harmony sounded from the celestial spheres."

Without a stable level of internal prices in any country it is difficult to attain a stable level of exchange, for as Prof. Cassel points out "the level of exchange corresponds to the purchasing power par." Frequent changes in the internal price-level of a country cannot but influence the rates of foreign exchange and make it impossible to seriously forecast economic and business conditions.

Having realised the advantages that a comparatively stable level of prices would confer on society, the economists and monetary reformers propose to attain this by influencing the monetary factor. Many causes, monetary and non-monetary, exercise their influence on the price-level. The modern currency reformers, however, aspire to control the price-level by exercising pressure on the monetary situation. Prices generally depend on the relationship between money¹ and goods. The real meaning of stability of prices is to stabilise this relationship between money and goods. If the stream and flow of goods entering into the market is ascertained and if the volume of money is made to correspond with this stream of goods, the level of prices tends to be stable. The most useful criteria to judge the volume of production are the employment index and the volume of unmarketed stock of finished goods.

It is a well-known fact that in our modern industrial society the banks "create" the major portion of the purchasing instruments. The creation and cancellation of all purchasing power is done by the banks. If, only, this policy of creating credit or restricting credit can be controlled in the real interests of society, the main

¹ Money does not mean metallic money alone but the sum-total of purchasing power which may consist of metallic money plus all other instruments of credit acting as substitutes for metallic money.

objective of the reformers would be achieved. The expansion or contraction of credit has to be so devised that the total stock of money is made co-equal with the volume of goods manufactured by the entrepreneurs of the society. The lending policy of the banks confers a boon not only on the borrowers of bank accommodation but society can be benefited to a large extent by enjoying a stabilised price-level. The lending policy of the banking system as a whole has to be regulated with this view-point and the Central Bank which is the guide, friend and philosopher to the other banks, is the proper authority to exercise this control, for the independent commercial banks have neither the commanding influence, power, ability nor the sense of responsibility to perform this important duty. The Central Bank is the custodian of the gold stock of the nation, the ultimate repository of all legal-tender reserves of the banks, the sole issuer of bank currency and the ultimate sheet-anchor of credit in all emergencies, and if it places before itself no other ideal than that of serving national requirements¹ it can secure this proper regulation of credit on which depends the stabilisation of prices.

According to Prof. G. Cassel the stabilising of the price-level is the economic goal that a banking system should seek to reach.² Prof. Keynes goes a step further and says that "in countries where a centralised banking system does not exist, this policy cannot be pursued with advantage. But they need not despair. They have only to secure a stable exchange value of their currency

¹ The supply of credit must be so regulated that no rise in prices and materially no fall in prices either, takes place. In order to keep demand for credit within the limits of available means the bank must apply interest rates fixed with that object in view but in their continual scrutinising of their demands for credit must also be able to effect the necessary restrictions. The main factor determining the interest rates throughout the entire banking system is the Central Bank's discount rate and in addition the Central Bank naturally possesses a very great influence owing to the general advice it is able to give to private banks as to their credit policy. A fixed value of the monetary unit can only be kept by properly limiting the granting of credit and principally therefore by a suitable discount rate." See "Money and Exchange after 1914," p. 103. See also his book "The Nature and Necessity of Interest," pp. 162 and 163.

² Prof. Foxwell says, "its chief duty is to the business world rather than to its shareholders and its chief purpose is to maintain financial stability rather than to make profit."

in another country's currency¹ whose internal value is quite stable." Mr. Keynes suggests that the United States of America and Great Britain should separately endeavour to secure internal stability of their price-level and other countries might then conveniently use the dollar and the pound sterling, both nationally-managed non-metallic currencies, as a basis for the stabilisation of their exchange ratio. Thus even international stabilisation of prices can be achieved by this method. Only if one large trading country like the United States of America or Great Britain were to stabilise their rates of exchange with this country's currency not only would exchange stability be secured but prices also tend to be stable in these different countries. Though Keynes has worked out this policy in an elaborate manner the best exposition of this policy of attaining economic stability through monetary regulation and credit control is furnished by Carl Snyder, the general statistician of the Federal Reserve Board of New York. According to him there are three definite stages in this policy.² Firstly, the stabilisation of the price-level should be set down as the correct objective. A definite norm has to be established and three per cent. variation round this norm has to be tolerated. Secondly, the principal means that should be adopted to secure this objective are the manipulation of the rediscount rate of the Federal Reserve Board as done in 1923 and the purchase and sale of securities known as the open market operations

¹ Suppose a country X follows this policy and regulates the exchange rate with England by raising 40£m reserve consisting of bills and other exchange investments which can be realised on the British and X country money markets. A continuous purchase and sale of sterling bills will restrict the fluctuation in the exchange value of the domestic unit of the X country. So long as the English price-level tends to remain stable at a certain norm the X country's price-level tends to remain stable at a certain norm. The X country's price-level also can be made stable to a certain extent. If X country's prices were to rise relatively to British there would be a tendency for the X country's currency unit to depreciate in terms of sterling. The sale of sterling bills can stem the tide for a time but the fund might become exhausted. Hence with the depletion of the fund measures for restraining credit have to be taken by the X country's currency authority and this would tend to remove the causes for the continuous depreciation. Thus if exchange stabilisation with one country say, Great Britain or the United States of America, is established it naturally follows that the X country's price-level would follow the course of the price-level of Great Britain or the United States of America.

² See the American Economic Review, June, 1923, p. 284; also the Journal of the American Bankers' Association, February, 1924.



of the Federal Reserve Banks. Thirdly, satisfactory information as regards the prices has to be gathered and forecasting indices have to be constructed to permit "anticipatory" action to be taken in the application of the above measure. This is to enable the Federal Reserve Board to take 'preventive' action instead of "compensatory" action after prices have changed. To forecast the future trend of prices he depends chiefly on the index of the volume of trade and the index showing the rate of turnover of average bank deposits.

None can deny that the Bank Rate can control credit and, through credit, prices. Historical examples can be quoted in proof of this fact. The raising of the bank rate can control credit and by restraining credit bring about or initiate a movement towards lower prices.¹ But this policy would be defeated if the Government would still persist in borrowing from the banks owing to its failure to balance its budget. The 'monetary brake' has to be judiciously applied at the psychological moment so as to prevent the boom of which the trade depression is only the inevitable result or reaction. No delay in the use of this weapon should be made for the rise in the price-level might be accelerated beyond any possible restraint.²

The more zealous supporters of the Bank credit policy go a step further and claim that it would solve the widespread unemployment problem that is engaging the attention of the public mind at present in all countries. It is claimed that even 'trade cycles' can be effectively checked by a wise and rational control of credit. Mr. Henderson who expresses this view before the recent Unemployment Conference held in London remarks as follows: "Let credit be controlled as neither to permit the boom nor to induce the slump when the stage of full activity is reached, let the banks hold trade

¹ Taking Japanese Banking history into account we find the Central Bank raising the discount rate from November, 1919, and the upward tendency in prices was arrested in March, 1920. In the United States of America the F. R. Banks raised the rediscount rate to 7 per cent. in May, 1920, and from that date the prices have commenced their downward march. In England the Bank of England raised its discount rate to 7 per cent. in April 1920 and prices commenced falling since that date. The same is the case with Norway, Denmark, Finland, Belgium, France and Italy. But in Germany and Austria there was no such movement in the Central Bank's discount rate during 1920, and it remained practically stationary at 5 per cent. See the Memorandum relating to Currency issued by the League of Nations.

² See R. G. Hawtrey, "Monetary Reconstruction," pp. 123-124.

there and hold the price-level steady. The moment there are signs that a boom is in progress, even though it be merely a cloud no bigger than a man's hand, let the brake on credit be at once imposed before any harm is done. The moment that there are signs that a depression is under way let credit be at once offered more fully and on easier terms and then this vicious circle of reactions will be reduced to a narrower and narrower radius until it may disappear altogether."¹ Prof. E. Cannan who took part in the discussion emphasised on the necessity to curb the boom tendency or "damp it down" but he expressed doubts as regards the efficacy of the bank rate in achieving this object. As he remarks, it is true that "the bank rate is only one charge" that the business-man has to incur and he would not be deterred in expanding the business by a "mere rise in the bank rate." The psychological influence of the rise in the Bank rate would tell its tale effectively. "A 10 per cent. Bank rate is a kind of warning to the businessmen that the boom is about to break and that prices are going to fall." This would have the desirable effect of checking business expansion for the business-man always considers the bank rate as the signal whose indications he has to implicitly follow. As Sir Charles Addis says, "a rise in the bank rate is considered by the business people as the danger signal, the red signal warning the business community of rocks ahead on the course in which they are engaged. A fall in the bank rate is the green light indicating that the coast is clear and that the ship of commerce may proceed on her way with caution."

Prof. Keynes says that "healthy markets would lead to stable production and the banks by influencing credit can create confidence in the minds of the businessmen as regards the continuity of healthy markets. The banks' sole duty is to see that businessmen do not anticipate falling prices, for it is this anticipation that causes unemployment. The businessmen should be assured, that when prices have risen by more than a certain measure due action will be taken to prevent prices from rising further and this action will diminish very much the expectation of falling prices which they would otherwise entertain."²

¹ See his opening speech on the Unemployment Debate at the London Conference.

² See S.M. Keynes "Tract on Monetary Reform"—pp. 36-38.



It is apparent from the above remarks that changes in prices are some of the determining factors in the instability of industry and if the banks were to administer an effective check by twisting the "monetary screw" much can be done to prevent undue expansion and mitigate the intensity of the crisis that would occur. All theories concerning the origin of the Trade Cycles emphasize on the necessity of the expansion of banking credit during the boom period. The competition theory, the diminishing utility theory checking demand, the underconsumption theory, the confidence theory, the sunspot theory, the rainfall theory, the overcapitalisation theory and the monetary theory have been propounded by the different writers to explain the crucial cause of the recurring business cycles in industrial societies. Prof A. C. Pigou admits that monetary causes might contribute their quota towards increasing the amplitude of industrial fluctuations arising out of non-monetary causes such as harvest failures or psychological assumptions on the part of the businessmen leading to errors of forecast on their part.¹ Whatever might be the cause that sets the boom or expansion tendency into operation the changes in prices and the banks obliging the businessmen with credit are emphasized by a large number of these writers. Prof Fisher describes the trade cycle as the 'dance of the dollar.'² Prof. Keynes who postulates that our modern society aims at monetary profits, says that "anticipated changes in prices have a profound influence on the course of production."³ Prof. Cassel has denounced all deflationary tendencies as they produce a "paralysing influence" on the course of trade and production processes.⁴ "It is no use speaking of about gradual deflation. Once it is made clear to every one that prices are to be brought down to a fraction of what they are now enterprise will very generally come to a standstill, borrowers must suffer terrible losses, banks will show themselves unable to resist the shock and the working classes must be exposed to unemployment to a degree which is in itself a serious evil and which involves a great danger for the maintenance of social order."⁵ F. A. Lavington argues that business

¹ See his recent book, "Industrial Fluctuations," Part I—pp. 207-227.

² Prof. Fisher, Journal of the American Statistical Association, December, 1923, pp. 76-80.

³ See Reconstruction of Europe, 18th May, 1922, p. 66.

⁴ See Prof. G. Cassel's speech before the International Chamber of Commerce, Rome, March, 1923.

⁵ F. A. Lavington, "Trade Cycles," p. 51.

confidence is the sole cause but "price movements react upon or reinforce the rise in business confidence. Thus there is a powerful cumulative influence or stimulus to trade activity. But within this movement are causes tending to destroy the confidence on which it is based, for on the one hand rising prices are sapping bank reserves and on the other the artificial profitableness of business and the excessive confidence accompanying it, leads to errors in business forecasts which sooner or later must be exposed." Prof. A. C. Pigou also reckons the influence of prices and says that "the liability of general prices to vary or in other words the instability of the standard of purchasing power is a cause tending to expand the range of the movements that occur in the aggregate wage-fund. Consequently the introduction of any arrangement capable of counteracting the cause would pro-tanto lessen the fluctuating character of the demand for labour and therewith the average volume of unemployment"¹ Prof. F. W. Taussig considers that "changes in prices have profound influences on the mind of the middleman, the wholesalers, jobbers and retailers who form the immediate purchasing public for the producers."²

If the banks can check unhealthy expansion during boom days and avert a possible monetary crisis they can also stimulate business expansion during days of depression. The banks can give 'castor oil' to cure the constipation of congested currency. This can be done by several methods with or without the co-operation of the Treasury. The lowering of the bank rate so as to tempt borrowers is often advocated. This method, again can succeed only if it is reinforced by the psychological influence, namely, the anticipation of rising prices and the certainty of realising profits. All economists realise this cardinal fact and disbelieve the specious half-truth which says that "cheap money brings good trade." But as one economist puts it "even lending money without interest would not help if the borrower anticipated a loss on every conceivable use that he could make use of the money."³ "Even speculators realise this," says Albert Straus. According to him "no rate however low will tempt borrowing for the purpose of purchasing a commodity whose price is believed too high and broadly

¹ F. W. Taussig, "Principles of Economics," pp. 405-407.

² See A. C. Pigou, "Unemployment," p. 122.

³ See R. G. Hawtrey, "Monetary Reconstruction," p. 142.

speaking, no rate, however high will by reason of its being high, restrain borrowing intended for the purchase of commodities which are believed certain to rise." Prof. Cannan also utters a warning against overrating the influence of the bank rate as the only potent instrument for conferring economic salvation on the community. In the pictorial language of Hartley Withers "prices, credit industry and enterprise are not a pipe for bank rates' fingers to sound what stop she please."

But these writers who condemn the efficacy of the bank rate weapon ought to consider that there are other supplementary measures which can be undertaken to bring about the desired end. The lowering of the bank rate can be coupled with the banks' action of lowering the deposit rate of interest to such a figure as to "push money off deposits into circulation."¹ If it is as low as the yield obtainable on investment on speculative stocks or so low as to encourage spending in preference to the form of remunerative saving, business expansion can naturally result out of the co-ordinated action of a low bank rate and an unduly low deposit rate of interest.² Nextly the floating of non-industrial loans by Local or Central Governments attracting the idle deposit money in the "bank pool" and causing it to be spent among the people will lead to the liberation of money tied up in the banks' vaults.³ The Government might resort to inflation of currency as the trade depression would naturally result in a shortage of Government revenue. The unemployment doles would increase the expenditure on the other side and this unbalancing of the budget forces the Government to inflate but the temporary boom "resulting out of this increased expenditure would naturally end in a trade slump producing consequences more severe than the first." Banking inflation as a result of loans granted to the Government might lead to the releasing of currency out of the 'banking pool' but it is not productive of manufactured goods and hence no business expansion might result.

¹ See L. B. Angas, "Reparations, Trade and Foreign Exchange," pp. 283-285.

² Quoted by Hartley Withers, "Bankers and Credit," p. 170.

³ "The policy of public construction can be so arranged as to prevent the major portion of factory unemployment and much can be done by a careful planning of the construction works that would eliminate the evils of unemployment." See Public Construction and Cyclical Unemployment by Dr. F. G. Dickinson, September, 1928, pp. 205-208, Annals of the American Academy of Political Science.

Thus there are several methods to release the "frozen deposits" in the banking pool but all of them would become ineffective if the consumers go 'on strike' and refuse to buy goods. The industrialists seeing no prospective demand for their goods would remain 'on strike' as it were and the banks cannot hope to influence them and make them borrow. This truth can be expressed by saying that "the credit system is not an automatic device that can be wound up periodically by measured forces under absolute human control."

Such are the potentialities and the limitations on the policy of credit control by the central banks. Within these limitations, however, the Central Bank's action can go a long way in imparting stability to the price-level and if we consider the other services that banks render to society one can easily understand the reason why banking and credit are regarded as the Philosopher's Stone by Bishop Berkeley. Saint Simon and Auguste Comte who were shrewd enough to realise the importance of credit and a banking organisation for the society, long ago remarked that "the bankers might wield all political power in a well-governed community."¹ But before this cherished and desirable consummation can be brought about the banker has to realise his social obligation towards the community and strive his level best to secure a steady price-level. The banker has to remember what Dr. Marshall said long ago "that it is worth while to do much in order to diminish the variations in the value of the monetary unit a little" and act up to this worthy ideal.

Prof. Fisher and other economists realise that an absolute and dead level of stable prices cannot be obtained by the Bank rate device. If Central Banks act judiciously and in unison it is possible to restrict the fluctuations within a narrow limit. As no additional legislation is required to secure this spirit of co-operation economists place

¹ There seems to have been a complete fulfilment of this prophecy in Great Britain during the years 1918-20. All measures have been framed with the express object of maintaining the lost credit and financial importance of the city. The restoration of the pound sterling, the liquidation of Britain's indebtedness to America, the deflationary policy pursued at this time, the turning down of the protectionist practices adopted during the war time, the return to orthodox finance, the attempt to make London a distributor of capital as before in spite of internal needs, and the attempt to sacrifice agriculture and consider finance and commerce as vital factors in the national economic structure have all been due to the dictates of the city interests and these are considered identical with the interests of the nation.

great reliance on this method and they are justified in this expectation for the ' non-metallic regulated standard ' of Keynes has been discarded by almost all important countries which have resorted to the gold standard. The universal value of gold is to be stabilised and under such a gold standard coupled with the price-stabilisation discount policy, relative stability of world and internal prices can be obtained.

The restoration of the gold standard has been the accepted feature of the recent monetary policy and all the suggested proposals to dispense with, uproot and thrust aside gold out of the monetary system have been laid aside. King Gold—the arch-exploiter of humanity—has been restored as a constitutional monarch but there is no assurance that his position would be stable. The ingenuity of man might very soon lead to the perfection of a less wasteful and more scientific and stable standard than gold. King Gold would be deposed if he refuses to obey the behests of the Central Banks and unless he permits himself to be " managed " by others the situation would become too stiff for him. The gold standard would be made to operate as a means to an end and gold would no longer be a master but a servant of the economic life of man.

General return to gold.

Undaunted by the bogey of gold getting rapidly cheaper or rapidly dear and conscious of the fact that neither politicians nor bankers can easily tamper with the world level of prices which the gold standard would bring in its train several countries have restored the gold standard. France and Italy have recently returned to the gold standard.¹ The credit and goodwill of the United States of America was extended to them so that their safe return to the gold standard may be vouchsafed. Under Mr. Benjamin Strong's (Governor of the F. R. Bank of New York) advice, a low discount policy was deliberately followed for four months in 1926 and again in the last five months of 1927 so as to allow the flow of gold to those countries who demanded its acquisition for establishing their currencies on a gold basis and roughly \$ 50,000,0000 worth of gold was exported from the United States of America. Whatever might be the methods by which these

¹ About 81 countries returned to the gold standard during the course of five years 1923-28.

countries attained the gold standard and financial stability the future of the gold standard must be assured. Europe's main problem is to prevent a fall from orthodoxy in currency matters as it experienced during 1914 to 1921. Each country has to gradually possess a sufficiency of gold against its note-issues and a substantial amount in excess of this in order to feel comfortable.¹ While this is the main problem the subsidiary one of stabilisation of the value of gold is a more difficult one for "the simultaneous and competitive efforts of the countries" to secure gold may lead to a 'scramble' and consequent rise in its value. Just as the U.S.A. stabilised the value of gold on a basis conforming with a stable level of prices in the country the attempt is to stabilise the international value of gold itself in relation to the world level of prices.²

Almost all the important countries of the world have realised that gold can no longer be a perfect measure of value, *i.e.*, contract or increase in such a way as to maintain the necessities of life such as food, clothing, machinery, coal and rent within a minimum of fluctuations as to value and the problem of international or world finance is to mitigate by preventive measures the financial entanglements that would be forthcoming in the train of a scarcity of gold

¹ Montagu Norman, the Governor of the Bank of England, expresses it in the following language: "The stabilisation of Europe is dependent on having over a series of years a certain supply of gold by which those various countries can gradually substitute gold for valuated; never going back, as I expect, absolutely to a gold circulation but nevertheless, over the years, each one gradually getting a higher proportion of gold against their note-issues. That, I believe, is the way in which Europe and countries beyond Europe may eventually solve the question of stability, of security, of note-issues, of prices and of co-operation one with another—all moving together forward.....I believe the advantage of the many as well as the advantage of each one is that this progress should be gradual and united."—See Answer 13740, Vol. V, Oral Evidence before the Hilton-Young Commission.

² This does not eliminate changes in prices of commodities within any particular country. The price-level of any commodity would depend on its production and the world demand existing for it. Fluctuations in internal prices would be the result of changing efficiencies, changing imports and exports so as to keep pace with demand arising from increasing population and its growing trade requirements or the demand for gold itself might be reduced to keep pace with existing and forthcoming stocks of gold supplies. The present world price-level must not be interfered with either by overproduction or underproduction of supplies with reference to demand on the other side. World prices must not be forced up by overproduction or dragged down by the lack of gold. The world price-level is now unfortunately linked with the small basis of a precious metal which acts as the chief regulating factor for the value of all the articles in the world's trade.



output. The present world price level is 150 per cent. that of the pre-war level. The problem in the future is to keep it stable at that level. The gold must be produced in such a quantity that the present price-level might be maintained.

It has been noticed long ago that the output of gold is subject to great variations and does not tally with the increased wealth of the world. At times it may be produced in greater quantities than the output of commodity and services production on the other direction. The industrial demand itself is subject to great variation. An increase in the wealth and prosperity of the people usually leads to increased demand for coinage as well as industrial purposes. It was the Joint Committee of the U. S. Department of the Interior that first pointed out that "the future of gold production is problematical. The gold output of the world seems to have passed its zenith and to be on the decline."¹ The calculation of various experts as Profs. Cassel,² Lechfeldt,³ Dr. Gregory⁴ and Joseph Kitchen⁵ need not be alluded to in detail here. All of them predict that there would be decrease of gold production when compared with the growing consumption of the world. The gold output seems to be on the decline and the 3 per cent. annual increase of gold that is required to maintain prices at their existing level or to keep pace with the economic development would not be forthcoming. After 1933 the scarcity of gold will be gradually felt and there would be steadily falling commodity prices, reduced prosperity, lowered standard of living and stationary trade or a slower rate of economic progress.

As against this view which the majority of economists hold, Prof. Fisher, J. M. Keynes and Edwin Cannan consider that gold inflation would result and prices in gold will not fall but will go on rising as before the war period and that to an inconvenient extent. "Unless the East is allowed to absorb gold there would be no adequate solution"

¹ See G. Peele, "The Economic Impact of America," p. 181.

² See G. Cassel, "Theory of Social Economy," Vol. II, Sec. 53 *et seq.* "The world's annual requirements of new gold in 1940 will be close upon 150 ms. sterling and he is of opinion that it will not be possible to supply even one-half of that quota."

³ R. H. Lechfeldt, "Gold Prices and the Witwatersrand," p. 37.

⁴ Dr. T. E. Gregory, "First Year of the Gold Standard."

⁵ Evidence before the Indian Royal Commission on Currency of 1926, Appendix 82.

says Cannan.¹ Keynes would retain gold for settling international payments and to form a war chest against emergencies but would on no score allow it to play any part in his managed system.² Fisher however endeavours to stabilise the price of the gold bullion dollar in accordance with the "goods dollar."³ Any huge amount of gold can be absorbed by the banking system without any rise in prices only if it is cleverly managed. This is what the U. S. Federal Banking system has done during 1922 to 1925.

While these are the diametrically opposite and conflicting opinions about the future output or supply of gold with reference to demand the present day signs do not justify any of the above predictions of either school.⁴ After all even those who have special technical knowledge of the gold mining industry may find it

¹ See E. Cannan, "An Economist's Protest;" also his introduction to Dr. B. R. Ambedkar's "Problem of the Rupee."

² See Keynes, "Tract on Monetary Reform," pp. 163-76.

³ Fisher, "Stabilising the Dollar," p. 105 (1920 Edition).

⁴ See Helffrich, "Money," Vol. II, p. 647.

The maximum production of gold was recorded in 1915 at 22.7 million fine ounces. The minimum was reached in 1922 when the output dropped to 15.45 million fine ounces. Since that time he points out that the tide has turned; the output for 1923 was 17.790 million fine ounces and for 1924, 18.826 million fine ounces.

For still more recent figures see the International Statistical Year Book, "The League of Nations," 1927 issue, pp. 110-11.

Gold production of the World.

In Kilogram.

		1913	1921	1922	1923	1924	1925	1926	1927
Total	Africa	311751	281324	249434	315910	330394	329164	340476	345110
..	North America	158717	104147	110501	113533	123537	126148	124194	124524
..	Carribean	33064	25057	27038	27322	27505	27550	26742	24709
..	South America	93925	21478	22379	22855	17674	15563	15009	...
..	Asia	45036	35461	36415	35715	35315	37198	38168	...
..	Europe	47148	3340	7147	10308	32656	33538	34570	...
..	Oceania	79828	28096	28339	27660	24882	21008	20327	20060
Total	World	769664	498903	481273	553203	591963	590165	599686	602133



hard to guess what would be dug out of the bowels of the earth. Economic prophecy is futile and mischievous. The same fate may be in store for any of these prophecies which befell that of the prophetic estimate of silver production by Profs. Carpenter and Cullis.¹

Is America holding the World's Gold Bag?

Though there is no consensus of opinion in this matter still it is true that America possesses a large stock of "free gold." Since 1914 gold was diverted to the United States of America and the gold standard was maintained. Gold exports were allowed under licence from September, 1917 to June 30, 1919. At present about £ 200 ms. of gold certificates are in circulation and the F. R. Board has about £ 550 ms. (*i.e.*) about 70 per cent. cash reserve. A stock of say £ 280 ms. can be released without any credit contraction. But if it were to be absorbed by the American people themselves there would not be even this "free gold." As bank deposits expand gold backing also increases. On August 8, 1922 the actual gold held by the F. R. Board was about £ 602 ms. against £ 562 ms. held in 1926. The ratio against combined deposit and note liabilities was about 77·8 per cent. America has become a long-term capital provider while she borrows for short term purposes. America is a great short-term debtor nation to the extent of nearly £ 400 ms. Any call of this gold would mean credit contraction, gold diminution and fall in commodity prices.² America's gold is susceptible to international influences and may be suddenly "vanishing" as Secretary (now President) Hoover puts it.

It is not only America but each country has to protect the gold stock and the banking system of each country has to administer and protect the gold stock held by it. International financial machinery is being perfected by the Governors of the important central banks of the world for the smooth co-operation on the part of the different countries to meet this contingency. To be forewarned is to be

¹ They estimated that the price of silver would not be less than 4s. to 5s. 6d. per ounce. Actually it was never higher than 43d. per ounce, thus falsifying their prophecy.

² See "The Economist," Sep. 12, 1927.

„ also „ Jan. 14, 1928.



forearmed and the joint efforts of American and London financial interests are to be exerted in the direction of stabilising the value of gold over long periods of time. A sort of financial League of Nations under the auspices of American and London financial interests is being formed to solve the gold problem.

What is the influence of annual gold production on commodity prices ?

The annual production of gold is an infinitesimally small portion of the total stock of durable gold existing in the world. It is the existing value that determines the value of the new out-put (*i.e.*) expensive mines would be thrown out of production. Thus the ordinary doctrine of value, namely, the cost of production does not govern the value of gold. The annual gold production does not affect the price level, even though it might be produced in large quantities. An appeal to history may convince the readers of the truth of the above statement. The stock of gold in the banks may be constant yet the price-level may be rising. Witness the rise in the prices of the U. S. A. during 1917, 1918 and 1919 when the stock of gold was fairly stationary. So also the stock of gold might be increasing and no changes in the price-level may be noticed or they might not prevent a fall in prices as in 1920 and 1921 in the U. S. A. One important fact to be inferred is that it is the credit policy that influences the price-level during the short periods.¹ Thus any action meant to stabilise the value of gold is essentially intended to stabilise its value over long periods of time. A deliberate policy to stabilise the value of gold can be pursued instead of leaving it to be determined by the combined forces of demand, supply and cost of production.

Suggested Remedies.

Very little energy has yet been spent in the search for methods of solving this problem other than those offered by reduction of reserve ratios or paring a little finer the gilt edge of the gold paper, the economy of gold in actual circulation, the use of international securities as recognised means of payment, the pooling of gold in the hands

¹ As Keynes says "the price level does not depend on the quantity of gold in the world but on the policy of Central Banks as regards their reserve proportions."—Tract on Monetary Reform, p. 178.



of the League of Nations to settle international transactions or the starting of an International Institute of Credit. Public attention has been drawn thus far to these four or five expedients alone.

Some uniform lower ratio of gold reserve to the note and deposit liabilities of the Central Banks of Issue can be adopted by international action. If gold is not to be adopted in circulation a lower ratio would not be found insufficient. Like the 'buried corpse' the gold would be in the hands of the Central Banks as an 'ultimate safeguard' and reserve for 'sudden requirements.' The essence of the idea is however to free the gold standard from the exclusive influence of gold. The ratio is after all a "convention" and public confidence would not be shaken by such universal reduction of reserve ratios to total liabilities. The whole theory of reserves of Central Banks can be briefly stated as follows. There should always be something in the reserve there and it is not also meant for employment all the time. Uniform Bank money expansion in all gold standard countries can be carried to a limited extent to offset the diminishing supply of fresh gold and it is possible by this action to maintain prices at a steady level.

Coming to the economy of gold in circulation no country in the world—not even Keynes' classical example of Egypt, is circulating gold to any extent worth mentioning. The gold bullion standard or the gold exchange standard are the chief variations of the gold standard which have been adopted by all countries which have resorted to the gold standard. The centralising of gold would tend to make it efficient and this economy in the use of available gold for monetary purposes is no less important than reducing the demand for gold for hoarding or industrial use. Gold is to be practically made dead for currency purposes. There is nothing undignified if gold is not used for currency circulation. The development of credit on a larger scale than at present would achieve this desired economy of precious metals. Every Central Bank should be empowered like the Bank of England to compulsorily acquire any gold bullion or currency not held for export purposes or *bona-fide* industrial purposes.¹

The use of international investments would affect considerable economy in the international use of gold. If all countries absorb and

¹ See Section 11, clause (2) of the 1928 Currency and Bank Notes Act of the United Kingdom.

hold such investments in sufficient quantity the payment of international indebtedness would be smoothly performed. The other capital poor countries including India must learn the advantage of holding these international investments. It tends to the development of the world's clearing system.

The pooling of gold in the hands of a Super-Central Bank of the League of Nations involves the maintenance of reserves abroad. This is subject to disadvantage for a country possessing a favourable trade balance would lose much by placing its gold abroad. It is after all deprived of the advantages of real economy of gold. It would be far better to keep it in the financial centres of the world for a prompt and ready use can be made.

Next comes the suggestion of an International Institute of Credit which is not however to be considered a bank.¹

While admitting the efficacy of the above remedies attempts should be made in other directions also to solve the problem arising out of gold scarcity. It would add to the reader's sense of the urgency of monetary reform if I submit my view of the problem and its possible solution.

¹ An International loan is to be floated by the International Institute of Credit for securing the necessary capital. It would give credit to all countries on proper securities up to the amount of their requirements for their balance of payments. A national exchange office is to be created in each country, to work in co-ordination with the Central Bank of Issue of the country and the International Credit Institute whose function is to act as an International Clearing House. By means of book transfers the International Institute of credit can make large payments without the intervention of bullion. This national exchange office alone being empowered to operate on the credit it has to operate it for the express purpose of paying international indebtedness of the country. Adopting the principle underlying G. E. Standard system the N. E. Office can operate this credit by issuing gold bills at a fixed rate (export gold point) to individuals who have to pay their indebtedness outside the country. Similarly the N. E. Office has to fix the gold import point into the country and accept foreign gold at this fixed rate or to purchase foreign bills at this rate with internal currency. The main advantage of this scheme is the rendering unnecessary of gold shipments and substitute in its place the purchase and sale of foreign bills payable in gold at rates approximating to the gold points. The economy of gold underlying their plan cannot be disputed. The National Exchange Offices can open branches in all trading countries and facilitate arbitration in agreement with the International Institute of Credit. The power to purchase private bills and sell them will facilitate the stabilisation process. This method of monetary reconstruction based on the principle of gold standard was first proposed by Luigi Luzatti in 1912 at the Brussels Congress. See Bertrand Nogaro, "Modern Monetary Systems," pp. 219-224.

*The Irving Fisher Method.*

The gold bullion units can be made lighter to check the fall in prices resulting out of gold scarcity.¹ An international agreement in the above direction of reducing the weight of the different gold units by uniform percentages would be quite feasible. This would however make quotations of exchanges very difficult to unravel.² But Fisher's plan involves the use of the Index Number which according to some economists such as Soetbeer, Porter, Sir R. Giffen and Mr. Sauerbeck is only a "rough indicator of the general trend of prices and should not be made the absolute guide or regulating basis of any monetary policy." Preventive action is necessary rather than ameliorative action. There is often a lag between credit changes and consequent effects on price level.

Without gainsaying the fact that this scheme can do something to mitigate the slow changes in the value of gold from having their influence on the standard of value it must be recognised that it is not a simple easily intelligible plan. The Index No itself is not considered as a satisfactory regulator of values. Prof. J. M. Keynes³ and Pigou⁴ would recommend other indices such as the state of employment, the volume of production, the effective demand for credit as felt by the banks, the rate on investments of various types, the statistics of foreign trade and the level of the exchanges. This is too radical a plan of action and involves a change from the present gold monetary standard which has a fixed gold content.

Draw gold out of hoards.

A campaign which tends to throw gold on the market would materially help the solution of this problem. Increased stocks of gold can be liberated. If India or any of these hoarding countries were to supply stocks of gold an extensive use of cheques and other forms of bank credit should become popular and the banking habit

¹ See "Stabilising the Dollar"—General Summary, pp. XXVII-XXVIII would give a bird's eye view of the whole plan.

² See Keynes, "Tract on Monetary Reform," pp. 188-189.

³ See A. C. Pigou, "Industrial Fluctuations," pp. 275 to 287.

⁴ See Hartley Withers, "Bankers and Credit," p. 249.

should be implanted. Such a phenomenon was witnessed on a large scale during the war time when private hoards of gold were liberated and the reserves of Central Banks were doubled or even trebled. These Central Banks collected the gold as "backing" for the paper currency issued during the period. The diminished supply from the gold mines can largely be augmented by the liberated gold from private hoards in order to meet the demand for gold. This demand for gold would itself be lessened if gold coins are no longer used in circulation and the new gold needed to fill the gap arising from the abrasion of coin would be no longer necessary.

But unfortunately the very discussion about scarcity of gold would tend to be canvassed far and wide and lead to further hoarding by the Governments, by banks and by private people for they think it best to hoard a metal that is likely to rise in value. They would take advantage of its present cheapness which might not last in the near future. Dr. Marshall considers this tendency as the famous law of hoarding. He formulates it thus, "demand for a metal for the purpose of hoarding is increased by a continuous rise in its value and diminished by a continued fall because those people who hoard believe that what has been rising in value for some time is likely to go on rising and *vice versa*." ¹ Effective checks against this public and private hoarding must be undertaken. A war chest is an instance of public hoarding and unless the dis-armament proposals are sincere this sort of public hoarding would go on unchecked. The Banks can release gold stock now held as security for loans and this released gold can be used for monetary purposes.

Can we lessen the industrial use of gold?

The consumption of gold in the arts would have to be reduced to a certain extent. But this would be difficult if there is gradual growth of wealth on the part of the people. As one economist puts it "gold is the satellite of man's ways and gyrations." It is difficult to order gold about and lessen one of its uses. Gold is considered as accumulated wealth economised by the people. This stored up energy is to be liberated in the purchase of consumable goods when

¹ See Answer—5, Royal Commission on the Depression of Trade and Industry, 1896.



desired. Such being the real reason it is not mere love of ornaments that can account for its extended industrial use.

International Fiduciary Currency.

International fiduciary currency notes not based on metal currency and circulating as legal tender in several important countries can easily be adopted as an international standard just as gold is being considered as an international standard. Gold is the international standard as the currencies of several countries bear a constant ratio to gold and gold can be converted into legal tender money in all these countries at a constant rate. Similarly international paper can easily circulate as money.¹

The abstract idea underlying money and the standard is the unit of account conception. It need not essentially be a commodity like gold. It is only an "object" or "ticket" which enables the holder to obtain in exchange for it the commodities required by him. This is the exact meaning of the term money and standard. So a standard to become international need only circulate in large number of countries and if it is issued in limited quantities it would constitute sound money.

The difficulties and dangers of international fiduciary currency are tacitly recognised by theorists as well as statesman. Doubtless such a plan would not be accepted by intensely nationalistic states which may consider their insignia of sovereignty impugned to a great extent by the circulation of international fiduciary currency within the borders of their country. Unless a great degree of international action is forthcoming the scheme cannot meet with success. An International Bank issuing fiduciary currency with a stable relation to gold can be considered nothing more than as fine idealism for the present. Though theoretically sound it cannot be asserted that the world is prepared to adopt this improvement.

¹ Prof. Marshall says : " for current business money needs only to be clearly defined, easily handled and generally acceptable and that these conditions can be easily satisfied by anything which has obtained adequate prestige from custom or from the edict of a public authority even though it would be valueless but for this prestige."—

*Resort to Barter.*

Changes in methods of payment such as resort to barter will have a profound influence in diminishing the demand for gold and the monetary service it has to perform. If only a money of account exists barter can be conducted in the modern days. The present day barter of modern international trade consists in changing goods for the money of account. If this enlightened system of barter were to be encouraged in internal exchanges within the country the need for gold currency circulation or extended use of credit needing additional gold backing would be given up.¹

Thus far the remedies suggested fall under two headings, namely, the reduction of demand for diminished supply of gold and increase of supply from other sources to fill the gaps caused by diminished supplies of gold output from the mines. Again each method outlined above depends on the isolated action of each country and except in the universal adoption of Fisher's plan there is no presupposition of co-ordinated action on the part of the different nations.

Conjoint action by the chief gold-producing countries.

It is theoretically possible to anticipate changes in the value of gold and correct them by intelligent action. A syndicate² of the chief gold-producing countries, namely, the United Kingdom, and the United States of America which produce about four-fifths of the total production of world's output of gold can undertake this co-operative action. There would be no difficulty in getting uniformity of action on the part of such small number of producers. The value of tobacco is regulated nicely by the Swedish Government. The gold producing Syndicate has to compensate the owners of mines out of its funds who would be forced to give up production of new gold when its value tends to fall as a result of increased supply with reference to the total

¹ See Lechfeldt, "Restoration of the World's Currencies," p. 56 and the following.

² Such refined barter was practised to a certain extent in Germany when the printing press began to produce disastrous effects on the price-level "whirling it up in a mad witches' dance." A great portion of the business was done in other countries' currencies such as dollars and other foreign currencies but trade and business were conducted on the system of barter to a certain extent.



demand.¹ As this is not likely to be the case and as demand for gold is likely to increase on the part of these countries which wish to give up the paper standard the total demand for gold would be very great and the long-distance course of prices would be lower or downwards. But if the prices were to fall slowly no action should be taken up by the gold-producing syndicate and it should be considered as a blessing for it would stimulate demand for industrial products and agricultural raw materials. But if the value of gold were to rise very abruptly it can be prevented by the gold-producing syndicate issuing paper certificates which have to be considered as gold substitutes. This enhanced demand would be met gradually by increased production but gold production cannot be within the complete control of the gold mining syndicate. Mechanical progress and productive efficiency of mining labour so as to obtain gold even from the low-grade ore can be secured under the aegis of the gold-producing syndicate. It might discover new methods of tapping gold from the bowels of earth or "any chemical process which draws gold from sea-water." It can also enlist the action of the Central Banks to support it at this juncture.

Conjoint action by the Central Banks.

The growth of co-operation among the Central Banks of the different countries can increase the efficiency of the credit system and the economising of gold for internal purposes can be secured. The development of paper money substitutes can be regulated. If the Central Banks can see that no undue widening of the gap between gold and paper is allowed and that different paper currencies and gold reserves bear a proper relation to each other and to gold the extended use of credit would bring salvation in the days of scarcity of gold. Each country has to co-ordinate its requirements for gold with reference to the general position of gold in the rest of the world.² The late Governor Strong of the F. R. Board of New York has successfully

¹ Undoubtedly much can be done within the law to bring production more in line with consumption and this checks price fluctuations. The "sterilising" of gold by clever banking control is also feasible in the advanced credit societies.

² As Hartley Withers puts it "Instead of each of the Central Banks pulling at the edges of the gold blanket they will have to work together to spread it out and smooth out the creases and make the most of it."—H. Withers, "Money," p. 79.



inaugurated the policy of co-operation among the Central Banks of Issue and if this machinery were to function continuously the future value of gold can be stabilised to a great degree. The gold standard must become the universal standard of value and the wider the use in which gold serves as a standard and is the principal monetary metal the less is the danger of a further fall in the value of the metal. The very cessation of inflation as a result of the universal restoration of the gold standard would mean lower prices and if costs of gold mining decline the production of gold might increase.

It is indeed true that a thoroughly perfect standard of purchasing power is unattainable.¹ It is only a comparatively rough standard that can be thought of and the international gold standard can secure this ideal better than non-metallic regulated and nationally managed currencies. By taking common concerted action on lines foreshadowed in the previous pages considerable variations in the purchasing power of gold can be eliminated and the future value of gold can be made a great deal more stable than without such common co-ordinated efforts in that direction. If instead of the old reserve-discount policy of the Central Banks or the creation of productive credit to satisfy every demand the price-stabilisation-discount-policy is pursued by the Central Banks of the gold standard countries the chief defects of the pre-war gold standard would be eliminated to a great degree. The price-stabilisation-discount-policy involves the changes in the discount rate as soon as a noticeable change in the following economic conditions is realised. Movements in the prices of speculative securities and all other prices, new orders given per month in the important industries or stocks of furnished goods in dealers' hands or percentage of workpeople out of employment and changes in the volume of credit are to be employed as the desirable signals for changes in the price-stabilisation-discount-policy of the Central Banks. Such careful manipulation of the discount rate was successfully accomplished by the F. R. Banking system of the U. S. A. and even in pre-war England many of these changes were also considered as indicators for variations of the Bank Rate by the authorities of the Bank of England. Prof. Keynes needed the extension of this policy into the

¹ See Dr. A. Marshall, "Money Credit and Commerce," p. 23.

field of non-metallic managed currency system proposed by him in lieu of the managed old gold standard system.

This is the ambition of the advocates of monetary reform who have recommended the restoration of the gold standard and India and China should not lag behind the other countries in this direction. A Central Bank of Issue has to be created and its sole aim should be currency and monetary reform based on a careful study of the banking habits and practices of the Indian people. The price-stabilisation-discount-policy cannot immediately be put into actual practice for the data on which the necessary alterations in the bank rate would have to be based are for the most part non-existing at the present time. There are no trade institutes to secure co-operation and run industries on economical lines. Nor does the India Government do statistical work on lines of the Survey of Current Business of the U. S. A. Federal Government. (As the use of cheques is so very little the Central Bank cannot immediately hope to control credit and purchasing power so very easily as Central Banks operating in credit societies can hope to do.) But it can hope to do something in the direction of controlling money rates in the important money markets where a short-term use of the floating balances of the banks is made.

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CHAPTER XVI

BANK ORGANISATION

The Clearing House—The development of the Cheque system—Branch Banking in the interior—Foreign branches—Bills of Exchange—Mechanisation of banking work and its possibilities.

The Clearing House.

Of some of the organisations which bring the different banks together, something has been said already of the Bankers' Association, and the Bankers' Guild. The Institute of Bankers whose special object is the education of the bank staff has also been studied. The most important piece of banking machinery is the Clearing House. Of the early origin of the Clearing House system in India nothing definite can be stated. But the present-day Clearing House system that exists in India does business on the model of the English Clearing House system. It has not copied the model of the American Clearing House. The English Clearing House may be defined as a device to simplify and facilitate the daily exchanges of items and settlement of balances among the banks. The Clearing House in America not only performs these functions and secures the well-known economies of time, labour and money but it goes still further and acts as a medium for united action upon all questions affecting the mutual welfare of the banks. An ideal Clearing House has to serve as a constructive agency for settling points of mutual interest.¹

The American Example.

In America some of the following functions are performed by the Clearing Houses.² They take up the question of extending loans to

¹ See J. G. Cannon, "The Clearing Houses," p. 11.

² It has been reported that an informal gathering of all the Joint-Stock Banks was held at the suggestion of the Imperial Bank of India to co-operate with each other and make the 1928 Rupee-loan of the Government a success. If an efficient Clearing House system were to exist in other centres also even a pro-rata distribution of the loan among the different banks can be undertaken and the loan can be floated on the money-market with the least apprehension.



the Government. They fix the minimum rates of interest which the banks pay to their depositors. They fix uniform rates of exchange and charges of collections. They hold an independent system of bank examinations. They issue Clearing House loan certificates to the banks doing sound business on good assets and on the strength of these certificates these banks can borrow. It was by means of this device that the American National Banking system tried to remedy the defects arising out of the absence of a Central Bank. As R. G. Hawtrey puts it "this process was a rudimentary analogue of the rediscounting facilities given by the great European Central Banks. It was an expedient born of sheer necessity and was itself an evidence of the urgent need for reform."¹ The Federal Reserve Act introduced not only a system of rediscounting approved commercial paper as in the case of the European Central Banks but it has revolutionised the old, ineffective, expensive and cumbersome system of clearing cheques. Prior to the formation of the F. R. system the various sections of the country were not served by a single set of clearing institutions efficiently co-ordinated and systematised. The indirect routing of distantly drawn cheques meant long delay in securing the return of cheques to the drawn bank. The F. R. system has instituted a country-wide par collection of cheques and member as well as non-member banks are included in this business. With minimum cost and physical effort domestic transfers of currency are taking place as a result of the institution of the Gold Settlement Fund in New York.

The European Continent.

On the European Continent the Clearing House system has recently been started² and it does not play such an important part because all the countries possess a centralised banking system possessing a large number of branches. These Central Banks do a large business in current accounts and the transfer and remittance of funds are accomplished largely by cancellations through book-entry.

¹ See R. G. Hawtrey, "Monetary Reconstruction," p. 94.

² See 1st Chapter, "Indian Money Market," p. 23.

The present situation in India.

Unfortunately for us we have neither a responsible Central Bank nor an efficient, enterprising and go-ahead Clearing House system as they have in America. If the Central Bank is able to throw open rediscount facilities to all the important banks the privilege of being on the rediscount list would be almost as much coveted as the privilege of being a member of the Clearing House. The Central Bank should scrutinise the position of all the members on the rediscount list now and again and weed out all unsound concerns from its list. This itself acts as a most salutary check forcing the ordinary banks to conduct their discount business on scrupulously clean lines and helps us to improve the banking standard. Such an extension of privileges would lead to closer co-operation between the Indian joint-stock banks and the Central Bank. It is only by an extension of this privilege that the Central Bank can extend accommodation to meet the growing needs of traders in India. A trader's bill bearing only one signature is never discounted by the Central Banks. The same should be the case with the Central Bank of our country. Hence there should be an intermediary to enable the trader to obtain the needed accommodation. There would be no greater and more secure intermediary than a joint-stock bank and it is only through these banks that accommodation will reach the mass of traders.

The importance of rediscounting.

Another grave reason why the rediscounting of commercial bills should be an important feature in the case of our Indian banks is that these do not generally possess ample financial resources. They do not attract much of deposit money, hence there is no reason why the banks should be hindered from supplementing their resources by having access to the Central Bank.¹ It should be considered a legitimate branch of their business and so long as these banks do not maintain a ridiculously small reserve simply because they can augment their

¹ In the Continental countries the smaller banks have access to the Central Banks by the rediscounting process and they are able to do much service to the trade and industry of these countries. In England the rediscounting of bills by the smaller banks is not liked by their customers who object to their paper being "peddled" about.

capital by rediscounting the bills easily there is nothing opposed to sound principles. Rediscounting is the only safest and cheapest method of placing credit facilities in the hands of smaller banks. Without a Central Bank of Issue these rediscounting facilities cannot be secured. So long as this Central Bank of Issue is not created there is ample necessity for creating the process of borrowing on Clearing House certificates. Taking the case of the recent winding up of the Bombay Merchants' Bank we find that it has been solely due to the locking up of 16 lakhs worth of assets in 16 lakhs worth of liabilities.

The number of Clearing Houses.

There are about eleven Clearing Houses in all : Calcutta, Karachi, Bombay, Madras, Rangoon, Cawnpore, Lahore, Ahmedabad, Delhi and Simla. The Imperial Bank of India facilitates the Clearing business in all these places.¹ More city Clearing Houses should be started and one such ought to exist at Amritsar, Lyallpur, Lucknow, Rawalpindi and Allahabad. The Imperial Bank has a branch operating in these centres. It should take the lead and start the Clearing House organisation. The private bankers should join the Clearing House organisation in order to increase their utility. The endeavour should be to link up all the various sections of our country and serve them by a unified and nation-wide system of Clearing cheques efficiently co-ordinated and systematised under the Central Bank's management. Even in a metropolis like Calcutta all the banks in the locality are not sometimes included in the local Clearing system. This means the possibilities of setting off debits against credits are limited when the system does not embrace all the banks which generally receive and collect each other's cheques.

At present 'out station' cheques are not cleared through the Clearing Houses. The latter have to be sent direct to the paying banker through agents or branches. This involves sometimes undue

¹ Cheques drawn on the Imperial Bank of India by other Banks are not universally passed through the Clearing Houses. In Bombay the practice of the Imperial Bank is to deal with such cheques direct so that the figures of Bombay are to a certain extent lower in proportion to the total amount of transactions than they are elsewhere. See p. 19, Report of the Controller of Currency (1926-27).

currency movements and the best way to mitigate this is to start provincial Clearing Houses under the management of the Central Bank and permit out-station Clearing of cheques. Inter-provincial Clearings should also be facilitated on the lines of intra-district and inter-district Clearing work done by the Federal Reserve Banks in the United States of America. Until such a plan is instituted cheques on the country banks would not become easily acceptable as cheques on the city bank.

✓ The increase of the Clearing House figures is often interpreted as a sign of trade activity and economic progress of the country. But much caution is needed in interpreting these figures. Even in a progressive country like England where ninety-eight per cent. of payments are made by cheques the people are careful in interpreting these figures. Increase in clearing business may be due to speculative activity on the Stock Exchange. For instance the figures of the Town Clearing of the London Clearing House are largely influenced by financial transactions. Metropolitan and Country Clearings are better guides for trade conditions. Metropolitan figures indicate the retail business of the metropolis and the Country Clearing indicates the general trade conditions. Coming to our Clearing House in Calcutta speculative activity is sometimes responsible for high figures. On the whole the prosperity of the jute, tea and cotton industries and business conditions does get itself reflected in the Clearing House figures. Slackness of trade and depression in any industry and decreased activity in share transactions and stopping of the sale of gold or reverse councils by the Government contribute towards checking the growth of Clearing House transactions.

The Development of the Cheque System.

The machinery through which the modern cheques are cleared has been studied in detail. The cheque system is not greatly in vogue. It is indeed true that an increasingly large number of cheques are passing through the Clearing Houses daily as the following table illustrates it.

BANK ORGANISATION

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(IN LAKHS OF Rs.)

Year.	Calcutta.	Bombay.	Madras	Karachi.	Rangoon.	Cawnpore.	Lahore.	TOTAL.
1914-15	26,695	15,783	1,881	1,162	4,312	...	...	49,833
1915-16	35,236	17,718	2,021	1,409	3,950	...	...	60,334
1916-17	49,289	26,228	2,529	1,736	5,068	...	...	84,850
1917-18	52,490	38,353	2,301	2,217	5,286	...	...	100,647
1918-19	74,113	56,946	2,545	2,230	7,385	...	...	1,43,219
1919-20	1,05,576	88,302	3,395	2,313	9,474	...	...	1,43,219
1920-21	1,43,993	1,31,593	7,579	3,342	10,484	663	...	2,97,654
1921-22	90,501	90,673	3,954	3,673	12,202	901	586	2,024,90
1922-23	98,025	85,873	4,513	3,358	12,596	793	849	2,06,008
1923-24	85,305	70,798	5,541	4,152	13,282	638	585	1,80,301
1924-25	95,411	62,166	5,596	4,613	11,721	572	557	1,80,636
1925-26	1,01,219	44,505	5,680	3,614	12,533	616	686	1,68,853
1926-27	96,101	42,268	5,453	3,107	12,442	816	770	1,60,957
1927-28	1,05,402	38,980	5,979	3,082	12,557	700	759	1,67,459

A glance at the above table¹ shows sudden increase of transactions in 1919-20 and 1920-21. This was due to sales of gold and of reverse councils by the Government; payment being made in cheques C. H. transactions were on the increase. In addition to these reasons there was great slackness of trade and increased activity in share transactions. Again in 1926-27 there was a drop in Calcutta and Bombay centres due to the business recovery and the lowered price of export staples. The steady increases in the clearing figures of Cawnpore and Lahore speak of the growing popularity of the use of cheques in the mofussil. Another lesson to be drawn from the 1927-28 figures is that there are changes in the procedure of the Clearing Houses at the different centres. When compared with Calcutta figures the Bombay ones are not so high. It does not however mean that there is less business activity in that centre.

¹ The above figures and explanation are taken from the annual reports of the Controller of Currency.

But there is no widespread use of cheques as in the English¹ and the American banking systems. It is the English banks that have been encouraging the use of cheques on the European Continent. The Paris branches of the English banks issue cheque books to their customers containing full instructions including a specimen drawing and crossing inserted in the book and the merchants and private individuals are now making a greater use of the cheque instruments in matter of payments.

So far as India is concerned the use of cheques is confined to the Presidency Towns and other big commercial centres and European merchants alone make a free use of these cheques and the development of Country Clearing in the matter of our cheque system will undoubtedly increase their popularity. The educated classes are slowly acquiring the habit of drawing cheques for large payments. The Government of India is also doing something in this direction. Sanction has been granted under certain conditions to the payment of land revenue by a cheque on the Imperial Bank of India. But very few people are in a position to take advantage of it. As in England cheques are not drawn for small amounts.

The cheque is looked upon as a thing so distinctively British as to be called by the late Lord Avebury—The Union Jack of Commerce—The cheque has invaded the domain of the bank note and the bills to such an extent that Mr. D. Drummond Fraser says that "the cheque has hurled the note from the pinnacle of its power." Before the recent war cheques were always drawn for high figures say—three to five pounds. When the scarcity of silver sent up its price to an unprecedented height and when the intrinsic value of the shilling coin became higher than its nominal value an increased use of cheques and paper currency was made even for very much low denominations as crowns. Owing to the financial necessity of war an increased stamp

¹ The growing use of cheques for financial transactions is mentioned in the annual reviews of Bank's Clearing House. This is despite the fact that the cheque has now to bear a two-penny stamp instead of a penny stamp as in the pre-war days. It is pointed out that the yield to revenue of the two-penny duty on cheques for England and Wales has steadily increased in the last five financial years from £ 2,504,000 to £ 3,182,000. The latest return represents approximately the cheques drawn per annum per head of the population. English women have bank deposits for their dress allowances and the payment of household bills.



duty was levied on cheques but the popularity of cheques was in no way diminished.

Our people should realise the advantages of cheque currency, the cheapness, the ease and economy that arise out of its increasing use. Well-devised cheque currency is the most elastic thing of its kind. A simple and suitable cheque system dispenses with the use of currency which might thus become available for the purpose of credit. The development of the cheque currency renders the metallic currency a matter of altogether secondary importance.

Obstacles in the path of cheques.

The following facts stand in the way of the popularity of the cheques. They have to be drawn up in a foreign language and a single erasure or mistake would lead to its refusal. Many of the Indian banks insist that the Rs. 25 limit should be adhered to (*i. e.*) cheques below that limit cannot be drawn. This figure is too high for many of the Indian people whose standard of living is very low. The characteristic of the Indian people which has distinguished them from time immemorial is plain living and high thinking. The sole object of the unsophisticated Indian mind is to secure a better and purer life by resorting to simplicity in clothing and food, sincerity in thought and deed, sweetness in disposition, fortitude in suffering, moral excellence in face of trials and temptations and abiding capacity for endurance and sacrifice. So long as this tends to make the standard of living simple and unostentatious the payments to be made, though they be many, do seldom come up to the required limit. Hence cheques are not increasingly made use of even by the educated people possessing a banking account.

Again the cheques are to be drawn in a foreign language and as it is a comparatively small part of the population¹ that is in a position to correctly draw it up in the English language the use of the vernacular on the body of the cheque might lead to its greater popularity.²

¹ A reference to the Statistical Abstract shows the literate element in the different provinces. The conception of literacy according to the Census authorities is indeed a crude one and every one who can read and write is considered as literate. Hence the English knowing and writing people might be actually smaller than these figures.

² The introduction of printed cheque books in Tamil by the Indian Bank, Madras, is an innovation which should be copied by the other Indian banks. In actual banking



The stamp duty on cheques has been removed¹ and although the Government has done its part of the duty in a satisfactory manner the banks have to play a more prominent part in the popularising of the cheques and even the Imperial Bank's common charges for collecting cheques drawn on other stations is very heavy and that of the other banks is only triflingly less heavy. This is a great bar to the free mobility of banking capital and should be removed at an early date.

India is a land of men of small means and of small transactions and too much use cannot be expected out of these cheques. As Hartley Withers says "the extensive use of cheques is possible only in a community which has reached a high stage of economic civilization and is also blessed with a high level of honesty among its members." In India the stability of government (*i.e.*) political security and an efficient administration of justice exist. But a high code of business morality, increasing density of population, mutual acquaintance, better understanding, continuous production, frequent and regular exchange operations and better accessibility of the banks will bring about a better development of the deposit and cheque system. In short the widespread use of cheques depends on the economic prosperity of the people and a large number of the people becoming the customers of the banks. As individual payments become larger and larger the use of cheques becomes substantial. The abolition of stamp duty would certainly attract more deposits for the banks and though transactions in petty amounts might be multiplied any clogging of the machinery of the clearing house need not be feared. As cheque

practice there are several difficulties placed in the matter of vernacular cheques. Many of the banks require that the customer should sign the cheque forms in their presence and fill the date, amount, etc., at the time of negotiation. In case of female signatures a countersignature by a magisterial officer is insisted upon. The Imperial Bank generally does not encourage vernacular endorsements at the back of the cheque.

¹ The real objection against the removal of the duty is the possibility of an undue multiplicity of cheques for small sums and the consequent trouble in the process of clearing. These are not however inseparable difficulties and if the people are taught the right use of capital at the right time there would be no danger resulting from this reform. Fortunately better sense prevailed and the stamp duty has at last been removed.

The United Kingdom would do well to copy this procedure and reduce the 2d. stamp duty on the cheque. Otherwise "chequelets" or some other device would be adopted to foster the use of cheques for small amounts and thus encourage the development of banking among small depositors.

payments become large the question of uniformity of size would crop up and every attempt should be made to print cheque forms of a uniform size so that there is convenience in handling, machining and sorting these cheques.

Branch banking in the interior of the country.

It has been stated already that branch banks should be started so as to extend banking facilities into the interior. Every economically advanced country has accepted the policy of branch banking as the safest possible means of expanding the utility of their progressive banks. Alexander Hamilton has been credited with the honour of being the originator of this branch banking system. Canada took it up. Both in Australia and South Africa there is a highly developed system of branch banking. It has become a settled fact and one finds it thoroughly established in the United Kingdom¹ and the continental countries.² But for the fact that the national banking

¹ It is stated that every week-day in England a bank or a new branch of a bank is opened for business. The following statement gives the readers an idea of the extension of the branches by the "Big five" of London.

Names of the "Big-five."	No. of branches.		
	1920	1927	1928 (Jan.)
Midland	1,483	1,953	62
Lloyds	1,500	1,700	50
Barclays	1,506	1,920	26
National Provincial	880	1,200	29
Westminster	789	957	18
Total ...	6,158	7,735	185

See Mysore Economic Journal, January, 1928, p. 34.

² The policy of the German banks is very progressive in the matter of branch banking. In addition to their head office they have "Filiales" or branches. They have also "kommanditen" that is silent partnerships in private banking houses supplying them with capital. They have also "depositen kassen" or deposit offices in all German cantons. Originally intended as deposit branches they have now become complete banking institutions by themselves helping parent banks to bring an increasing circle of clientele and help the issuing power. It also extends the cheque, giro and clearing business of the parent bank. Vide Dr. Reisser, "The German Grossbanken."

law of the United States of America¹ has prohibited branch banking and that some of the various state laws do not encourage it, it would surely have spread itself there also. With the passing of the Federal Reserve Act of 1913 a change has come over the situation² and the National City Bank of New York is organising its foreign branches systematically. Even the Federal Reserve Banks are now allowed to have branches in their districts. Owing to keen competition on the part of the State Banks there is a widespread belief that the only way of helping the National Banks of the United States of America out of the situation is to allow them to extend their branches³ in those states where the privilege of branch banking is allowed. The provisions of the National Bank law are also being made more liberal than before with the view of preserving the National Banking system as a whole. The main lesson that we learn is that the evolutionary development of international banking and the branch system gradually dispenses with the services of the intermediaries and leads to greater and all round financial strength, efficiency and responsibility.

India ought to learn and profit by examples set by other countries. All the sound banks doing business on conservative lines should be made to extend their branches into the interior and establish a network of banking establishments to serve as connecting links between the various parts of the country. The starting of new banks is a difficult affair and whatever might be said in favour of independent local banks the verdict of experience specially in the United Kingdom and Canada has gone against it and the branch bank system has come into vogue.

The opening of branches will afford an outlet for the surplus capital at the head office and minimise the danger of its being invested

¹ Vide H. P. Eckhardt, "A Rational Banking System," pp. 1 to 7.

² The growth of the National Banks is not the same as in the case of the State Banks and about 296 National Banks have surrendered National charters to work as State Banks under State laws.

³ At the present time in the United States of America there are 28468 National and the State Banks and only 681 of them have branches—The MacFadden Act of 1925 governs the extension of branches by the National Banks. A branch can be opened by it only if the State laws permit such a thing and only if the municipality has a population of at least 50,000 and even then one branch alone can be opened there and two branches can be opened in the area of the municipality if it has not less than 100,000 people.



in hazardous undertakings. They afford facilities for the transmission of money from one place to another and can easily bring about a proper distribution of capital according to relative needs of time and space.¹ Uniform interest rates can thus be easily secured. The small traders can be educated as to the advantages of a banking account. The branches will afford the best possible professional training ground for young people desirous of a new career. Expenses of management can be economised. The opening of branches all over the country would lead to an elimination of the banking risks involved in financing industries to a great extent. A branch bank can spread its loans over several industries which an independent local bank cannot hope to do.

It will lead to an increase of loanable funds.² The various branches will give ample facilities for gaining accurate information of the credit standing of the customers. The branch bank system may be easily extended to places too small to support a regular bank which requires a full complement of officers and reserve of coin. A unified policy is possible during periods of emergencies. The system of clearing would become simple and effective and a greater use of cheques might also be expected.

Defect: But there are some disadvantages of the branch bank system. Each branch is a source of weakness, and loss at one branch may lead to a run on the whole establishment of which the branch is only a part. The branches may tend to rival the older establishments of the place, if any, and this rivalry may lead to the lowering of the banking standard. There may be a falling off in the nature of securities against which banking accommodation is sought and overbranching may lead to overbanking and the extreme rigour of modern competition will force the numerous branches to tout for unsafe and

¹ Sir Blackett echoes the same opinion when he says "that the steady extension of business of banks conducting business on sound lines leading to the extension of banking facilities will provide one of the promising prospects of eventual relief from the difficulties of seasonal monetary stringency." Speech while opening the Central Bank's Calcutta Branch.

² "The deposit habit," as Bagehot says, "is a very difficult thing to begin because people do not like to let money out of their sight without security still more cannot all at once agree on any single person to whom they are content to trust it unseen, and unsecure." But a branch of a big city bank conducting business in their midst effectively dispels this suspicion from their minds.

risky business. An undue and disproportionate multiplicity of banks will be co-existent with a tendency to indifferent banking finance. Small independent banks may be driven out of existence. Too many branches and all of them working under rule of thumb methods will tend to stifle intelligence and the branch bank system might tend to remove superfluous capital from the provinces into the metropolis and then the provinces might view this draining away of money with disfavour. Delay in the matter of granting loans would result to a certain extent as there is the necessity for reference to the head office while sanctioning a loan.

Many of the above-mentioned disadvantages are not inherent in the branch bank system nor are they the inevitable concomitants of it. Most of them can be eliminated by instituting a system of effective audit and insisting upon weekly reports of business from the heads of branches to the head office. There should be a clever training imparted to these officers at the head office before they are sent out as heads of branches. An efficient peripatetic supervision¹ by the manager of the head office would obviate many of the above defects. Some of the directors should make unexpected visits at the branch offices to see the way the business is conducted. If the branch banks are established in response to actual demand, if they follow strictly the legitimate duty of attracting deposits, if they confine themselves to mastering the credits of their customers, if they keep down expenses to a proper level and if they eschew all rivalry with the existing older banks and be amicable with new rivals that may enter the field there is no reason why they should fail and cause ruin to the parent bank. Local businessmen may be appointed to advise the branch managers as to the granting of loans and to study the needs of particular localities and gauge the personal credit of the customers of the bank. Reasonable allowance of power and discretion of action should be allowed to branch managers who may be induced to identify themselves with the people of the locality by their activities and pursuits. Frequent changes in the personnel of banks would give no scope for the perpetration of fraud on the part of the bank officers. If the above injunctions are strictly observed by the branch managers the branch

¹ There should be a chief inspector for each large bank and these inspectors must issue confidential reports as to the state of banking business conducted by the branches.

bank system affords the best solution of increasing banking facilities in any particular country.¹

Special circumstances of India.

Although the salvation of India lies in this particular direction several well-informed people consider that a rapid increase of branches can never take place as there is a pitiable dearth of trained banking employees available to work these branches satisfactorily. Some are of opinion that it is of no use to merely increase the number of branches so long as the present psychology of bank depositors continues unchanged. The first breath of ill-wind scares away the Indian depositor and a convincing testimony occurred so recently as in the case of the failure of the Bengal National Bank.² The late Sir Bernard Hunter said long ago that the Indian customers go in to the branches only for loaning purposes. As the inflow of money is not very substantial the branches act only as an outlet for the remunerative employment of the parent bank's loanable resources and not as feeders to the slender resources of their parent banks. The question of expense has also to be reckoned. At least five to ten years must elapse before the branch can be made to pay its own working expenses. Mr. M. M. S. Gubbay says "that branch banking is impossible as sound and liquid investments are not to be had in the interior and branches cannot hope to utilise their working capital in sound, conservative and automatically self-liquidating investments."

Actual practice.

Coming to actual practice one finds that the branch bank tendency has taken root in this country. Owing to the mammoth expansion of the Imperial Bank and the recent bank failures the

¹ The wastes arising out of competitive banking can be controlled by efficient supervision at the head office and the main aim of the management of the head office should be to abolish preferential treatment to few favoured customers and high rates in established centres of business to counteract the low rates in undeveloped regions.

² The depositors of the different loan offices of the Bengal Province began to feel the pressure of the depositor's call and the Federation of the Bengal Loan Offices was more or less a defensive action on their part to strengthen their hands at such time when the depositors become unreasonable and insist on the prompt payment of the deposit.

managers of the indigenous banks are diffident as regards the policy of branch expansion.¹ No doubt these conditions will soon pass away but the lack of trained banking employees to work the several branches is a real obstacle in the path of extension. This absence of trained bank officers has been chiefly due to two reasons. It is only the European people that have monopolised the banking business as their avocation and few qualified Indians aspire to have a successful banking career. The unsympathetic attitude of the managers of the immigrant banks is partly responsible for this state of affairs. While the European officers are shifted from department to department to grasp their routine the Indian officer has to literally rot in one department before he can obtain the opportunity to master the work of another department. This unconscious stifling of all chances and narrowing the scope of his vision have tended to deaden his faculties. It is a matter of poor consolation to record that only eighty officers have been allowed "to rise from the ranks" and undertake the management of the newly erected branches of the Imperial Bank of India.

As regards the psychological objection it must be remembered that financial confidence is a plant of very slow growth and needs careful nurturing. It is barely a few years since our Indian banks managed by Indian officers have been conducting business. Mutual confidence between the bankers and the public is only a question of mutual sympathy and general prosperity.

Coming to the argument of the late Sir Bernard Hunter it must be noticed that it is not a serious objection to the starting of branches. Only he has advised caution on the part of bankers who may be anxious to increase these branches out of all proportion to the loanable capacities of the banks. When requested by the late Sir David Yule

¹ The following table shows this tendency clearly :—

Name of the Bank.	Branches (1922) including agencies.	1925
1. The Central Bank of India, Ltd.	16	17
2. The Punjab National Bank	25	34
3. Bharat National Bank	6	5
4. The Poona Bank	6	closed.
5. The Bank of Northern India	5	closed.
6. The Indian Bank	4	5
7. The Bank of Mysore	...	9
8. The Bank of Baroda	...	15

to reorganise the Alliance Bank of Simla his first advice was to close some of the branches which were not earning any amount of profit.¹ Any dissipation of the Bank's reserve in several places would tend to increase the vulnerable parts in its armour. It must have been this argument that must have prompted him and other founders of the Imperial Bank to refuse to accede to the wishes of Rai Saheb Seth Nathmal who wanted the Imperial Bank to establish its hundred branches in places which did not possess any banking facilities. As a banker's bank its position must be impregnable.

Neither is Mr. Gubbay's objection a formidable one. The branches would have to lend on the general credit position of the borrower and even in case of internal bills the attending documents would not be forthcoming. In America, England and on the European Continent such domestic bills are discounted freely by the banks when they are satisfied of the genuineness of the transaction which has given scope for the creation of the bills. With the help and co-operation of the shroff such bills can be secured easily and if the banks can secure a central re-discounting agency these bills can be easily drawn in a form acceptable to the banks. It is the duty of the banks to accumulate a reserve as a provision against bad and doubtful debts and as an equaliser of dividends.

But the remarkable pity of the present situation is that branches are not established in places which do not possess banking facilities but only in district capitals, populous towns and the chief monetary centres where banks already exist. Banking facilities should be extended into the interior of the country. The small agriculturist, the

Name of the Bank.	Branches (1922) including agencies.	1925
9. The Allahabad Bank	...	34
10. The Benares Bank	...	5
11. The Punjab and Sind Bank	...	29
12. The Ajodhia Bank	...	6
13. The Frontier Bank	...	10
14. The Nedungadi Bank	...	14
15. The Imperial Bank of India	...	168

¹ See Sir David Yule's speech to the shareholders of the Alliance Bank of Simla at their annual meeting held on August, 1922. A reserve for branch banking can likewise be accumulated and though it would prove a burden on the general profits in the beginning yet in the long run it will enable the banks to extend branches and help the general economic development of the country.

petty artisans and the local traders are those who are the chief sufferers and our banks should by extending their deposit, discount and loaning functions spread a useful fringe of benefits over the entire community and protect it from the capitalist money-lending traders. The Report on the Moral and Material Progress of India¹ says "there are at present in all India under hundred head offices of the banks with 322 branches. The proportion of the total towns in India with a population of ten thousand and over in which banks and their branches are situated is still only 25 per cent." The following table gives us an idea of the joint-stock banking institutions of the following countries:—

	India.	The United Kingdom.	The U. S. A.	Canada	Australia	Japan.
No. of Jt-St. Banks.	74	20	27,000	14	18	1,585
Branches.	500	9,381	...	4,000	2,795	4,000

The private bankers, *i.e.*, the Marwari banker and other indigenous confreres of his carry on a lot of banking business but no statistical information can be obtained as to the number of their agencies and branches. Making due allowance for these one does not find that branch banking has progressed very favourably in India. It has been estimated that no less than 9,547 banking offices exist in the United Kingdom and although India is nearly 15 times greater in area and seven times larger in the matter of population than the United Kingdom one notes that it is seriously underequipped in respect of her banking institutions. In Scotland one finds that "every village has its own bank," and MacLeod says "what Nile is to Egypt so is the banking system to Scotland a fertiliser." Happy would be the day when each big Indian village would be in a position to boast of

The Peoples' Bank of Lahore had 80 branches; The Alliance Bank of Simla had 51; The Tata Industrial Bank, 26; The Industrial and Exchange Bank of Bombay, 40; The first two banks have failed. The third has amalgamated itself with the Central Bank. The fourth has recently suspended payment. (March 10, 1924.)

¹ "India in 1921-22" edited by L. F. Rushbrook Williams.—The situation is still the same. We have only 100 Indian Joint-Stock Banks with about 500 branches. This does not reckon either the Imperial Bank and its branches, the Exchange Banks and their branches and the private bankers and their establishments.



its own humble banking office. At present many a town¹ with a population of 20 to 40 thousand inhabitants goes without even a branch bank whereas in England "every town with a population of 20 thousand people has been over-banked." In many places the starting of a branch bank is viewed with apprehension and every attempt to tout for business is deprecated.

Unfortunately the case is not so with India. In the first place there are not many big banks conducting business on sound and conservative lines—the Imperial Bank and the Exchange Banks excepted. The rest of the banks with the notable exception of the Allaha-bad Bank are new-born institutions and the crisis of 1913-15 mercilessly weeded away the speculative and the less stable of the Indian Joint-Stock banks. The rest of the banks are labouring under the difficult and slow process of building up their business but it is apparent that the existing number of banking offices are totally inadequate to meet our growing needs. As the Indian Industrial Commission says "the banking facilities are purely non-existent to the major part of our population."

But a far greater number than the existing branches are required. In short the crux of the situation lies in the attracting of more capital to the vaults of the banks. This should be done by increasing the authorised capital after getting the necessary legal permission. Our old and well-tried banks which have borne the scrutinising tests of time, and have come out purified and strengthened by the ordeals of several crises should extend their branches. It would be extremely unwise and dangerous to entrust our deposits to new banks whose integrity has not been proved, whose stability has not been put to the test and whose solidity is still a matter of doubt. These will be subject to all the ills of infant banking and India can ill afford to lose the little capital she possesses. The next phase of development in our banking business would be the financing of our country by means of a well-devised system of branches strategically situated so as to tap the deposits of the people and minister to their economic needs wisely and beneficially.

¹ The Government of India looks forward to the establishment of a branch of the Imperial Bank in every District and every town of importance. Roughly speaking there is at present one banking office for every 9,00,000 persons in India.

While in Western countries attention has been drawn to the branch bank *versus* the independent local bank controversy, in India on the other hand some ignorant persons find an apparent conflict of interest between the branch bank expansion policy and the development of the urban co-operative banks. Mr. H. Duperne and Sir J. C. Coyajee have been the staunchest exponents of the Urban Banks' extension policy. Both of them realise that the Joint-Stock Banks are handicapped as their foreign managers find it difficult to expand their branches and gauge the personal credit of local customers. This is the real limitation to the development of the immigrant banks in this country. Hence Co-operative Urban Banks should be started to mobilise the unorganised capital in the interior, to provide financial facilities for the small industrialists and the artisans, to familiarise the people with forms of credit such as notes, cheques, hundies, and bills of exchange and give them sound education in the matter of paper currency circulation.

But there are certain difficulties hindering the growth of the Co-operative Urban Banks. The want of leadership, lack of true co-operative spirit, the spirit of commercialism, lack of adequate financial facilities, lack of capable management and a wide difference in the moral outlook of the town people are some of the chief difficulties and they have not increased to such an extent as the agricultural credit societies though both have been started at the same time. It is only in Bombay, Ahmednagar, Poona, Belgaum, Dharwar, Calcutta, Chittagong, Mymensingh, Pabna, Jalpaiguri, Madras, Chingleput, South Canara and Salem that one really comes across progressive Urban Banks.¹ As the bonds and basis for co-operative union are so very many in our society even this little success has been rendered possible. The great sociological factor caste has been contributing to their success. Moreover the failure of the "mushroom" swadeshi banks has given a decided impetus to their growth. The different Railway Employees' co-operative urban societies have also been flourishing mainly due to the privilege of deducting loans at the source out of the borrowers' salary.

¹ The following table shows the progress of the Provincial and Central Co-operative Banks and Urban Co-operative Credit Societies with limited liability and a capital and reserve amounting to 1 lakh of Rs. and above. As in the case of the Indian Joint Stock

But much more real work can be done by utilising the machinery of Committee management as in Italy and employing banking officers or trained members of the Indian Co-operative Service as secretaries of these Urban Banks. It is only by these Co-operative Urban Banks or by a development of the branch bank system that banking facilities can be organised. Till then "the Indian people will be minus all that makes the wheel of life turn smoothly, minus water, food, clothes, oil, sanitation, doctors, medicine and education. These are chiefly traceable to money that vacuum in the body politic—the banking system for which India so wearily waits."¹

Foreign Branches.

The scope of the Indian Joint Stock Banks must expand and they must accomplish more to-day than what they have been doing in the

Banks the Statistical Dept. has introduced a classification and all Urban Banks possessing 5 lakhs and over are classified in class A and those possessing 1 lakh and over and below 5 lakhs are placed in class B.

Class A.

Class B.

Year.	No.	Capital and Reserve.	Deposits and loans received.	No.	Capital and Reserve.	Deposits and loans received.
		Rs. (1000)	(Rs. (1000)		Rs. (1000)	Rs. (1000)
1916-17	2	1111	2503	21	2775	14945
1917-18	3	1832	5279	24	3049	15234
1918-19	4	2467	13544	29	4060	15737
1919-20	2	1442	9634	29	6408	26379
1920-21	5	3656	22938	36	6995	24890
1921-22	5	3976	28268	46	9404	36300
1922-23	5	4360	34105	63	13105	70202
1923-24	8	6235	41399	71	17148	58432
1924-25	8	6926	45141	90	16681	79447
1925-26	10	9062	53783	98	19552	89701

¹ See Sir Daniel Hamilton's Essay on "The Policy of Development" in the Indian Co-operative Studies, p. 255.



past. The vital need for the future is to establish such banking institutions as would render all the services which a customer would require either in this country or elsewhere without "splitting" up his account. With a growing population and ever-increasing manufactures and trade it requires an expansion in the outlook of the bankers who shall not be hampered by restrictions in the available quantity of banking resources.¹

It is not only in their own country that the English and German Commercial Banks try to establish their branches but they attempt to establish themselves in the chief monetary centres of the world. Failing to establish a foreign branch they at least make some working arrangements with foreign banks and get themselves represented in the foreign country. The practice of holding shares in foreign banks has become an established fact in the English Banking system. During the war the first purchases of Irish Banks were made. Scottish affiliations were then taken up. Many of the English Banks combined to have a foreign bank or attempted to hold a controlling interest on a large-scale in various Colonial and Overseas Banks.²

Some of our Banks must be international banks thoroughly organised and do business of an unimpeachable type. Our growing trade with Japan and America is becoming an established fact and foreign branches at Tokio and New York³ will not fail to be advantageous concerns. At least international alliances should be formed. Foreign institutions are encroaching a bit too freely on our domestic business. The interests of Indian businessmen would be better served if "All-Indian" banking facilities can be afforded.

¹ Under their guidance and advice they must venture to trod the hitherto unbeaten tracks and finance the petty artisan and the small trader.

² The British Overseas Bank is practically meant to operate as a *common foreign department* for some of the smaller Banks of the L. Money market. The British Trade Corporation was mainly intended to provide British foreign banking facilities in different areas so as to encourage British manufacturers and Traders without at the same time competing with well-established institutions.

³ In New York branches in the fullest sense of the word are not allowed. Agencies can however be established and for this a foreign corporation has to pay a licensing fee of 250 dollars annually to the Superintendent of the State Banking Department. It should also satisfy him as regards its financial stability and its powers under its foreign charter to open an agency. It must make certain returns in accordance with the provision of section 147 of the Banking Law of New York.

The advantages of such a policy are many. It is not out of patriotic desire to see India represented in the foreign field that the starting of a foreign branch is recommended. A systematic encouragement can be given by them to their customers "to get a footing" in the foreign markets. Trade information and credit intelligence of trading firms all over the world of a highly practical character can be gathered by the intelligence department of the foreign branches. It can link domestic with foreign customers and expand India's growing trade and seek an outlet for marketing her manufactures. They can take up the financing of foreign drafts for exporters at all times. It is true that the Exchange Banks are now doing this business, but there would be a systematic policy on the part of the Indian Joint Stock Banks¹ to help the domestic trader to get into living touch with the foreign market and it is undoubtedly true that "trade follows the bank as much as the flag." *the money*

The parent banks can profit by transacting foreign exchange business with the help of their foreign establishments. There is no reason why the Indian Joint-Stock Banks should not undertake exchange business and finance the domestic trader's foreign drafts. The jealousy of the Exchange Banks would stand in the way but there is no reason why they should resent fair competition with such strong institutions as it would force them to conduct their business on safe and sound lines. Competition among several banks to do this business means the importers and the general public would be able to purchase their drafts at a lower price than formerly.

The clientele of the bank reap ample advantages in transacting the whole of their banking business with one bank. They make international payments or obtain ample credit facilities in the United Kingdom and in the foreign countries. The foreign branch may serve as a good auxiliary through the medium of advertisement and personal invitation to attract deposits. It may obtain much prominence for the parent bank among the foreign banks by whom its foreign exchange is purchased and among the other banks of the world with

¹ They should make it a systematic policy on their part to insure stability of foreign exchange transactions by means of forward contracts. The present exchange banks do not specialise in this business.

whom accounts are kept and by whom drafts against its letters of credit are negotiated.

The foreign branch of a bank practically transforms the parent bank into an international banking institution and thereby vastly expands its usefulness and places it in close touch with long established industrial and monetary centres of the world. As our national savings and income expand the foreign branches of the bigger Joint-Stock Banks may enable them to place their funds at remunerative rates of interest whenever an opportunity affords itself in the money markets of the world, by the purchase of foreign bills of exchange as an investment, or permit them to borrow funds at favourable rates in the money markets of the world by issuing finance bills. The foreign branch may enable the parent bank to cultivate friendship and comradeship with the master financiers of London and New York whose opinion as regards Indian financial matters will be of much value to the Indian banks.

These are some of the advantages of a foreign branch if it is soundly and conservatively managed. America which was so long dead against the branch bank policy has deliberately undertaken the opening of foreign branches to help their customers. The National City Bank of New York has 45 branch banks in its foreign system and is contemplating an expansion of its business in new fields. They have a number of foreign trade experts whose sole business is to furnish the domestic exporter with the information of the state of foreign customers, the nature, extent and volume of their business and lastly the bank finances the foreign drafts of the American exporter. He opens a current account with the bank and turns over all its foreign drafts to this bank for collection by its foreign branches and this sum is credited to the customer's account. He makes an agreement that the bank should accept all the clean drafts drawn upon the bank itself to a certain limit which is determined by the volume of his export trade and thus the domestic trader finances himself for the short period in the most economical manner and this policy has been styled "the refinancing by acceptance" and it is by this means the bank encourages the foreign trade business.

It is high time that some of our banks should learn such methods and expand their field of operations from domestic banking to wider

fields of international finance by opening foreign branches or starting separate banking companies in the foreign countries working solely under their control.¹ They should study local conditions in foreign countries carefully. They should secure continual advice and co-operation of men acquainted with important business firms. They should take precautions against losses arising out of currency fluctuations. They have to adapt themselves to surrounding conditions, including laws, business customs and observe the precedents of local banks. The foreign branch must first start its business by dealing successfully with foreign exchange operations. The foreign banks would have to purchase and make advances against commercial bills drawn on importers in the country where they transact business. Under all circumstances they should avoid over-extended foreign commitments.

The foreign branches must enable their home office in India to develop acceptance business. It is only after a successful transaction of this business that loan and discount business should be taken up. The attracting of current local accounts can then be systematically pursued. Their advances must be of a short-time nature. Foreign commerce can benefit the bigger Indian banks by furnishing for their funds a legitimate and genuine field for use and thereby lessens the temptation to enter the arena of speculative investment. But service to the domestic clients should be the sole object and the profit-making motive must be subordinated. Domestic traders can also be provided with convenient facilities for securing finance abroad.

The misguided notion that foreign branches eat up the parent bank's capital and draw funds away from domestic use is not at all correct. A foreign branch is a costly affair and it certainly takes a long time to establish its reputation for honesty. But it may then attract more deposits than what it actually lends there. Originally the Indian exchange banks could not attract Indian deposits.

¹ This can be resorted to in case the taxation levied by the foreign country is very heavy and is likely to wipe out any profit that can be forthcoming. This is exactly what the Westminster Bank did when the Spanish Government began to impose a tax on the entire capital of the Bank. Of late some people have been recommending the very same measures in this country but they do not realise that it can be easily evaded by registering separate companies.



They relied to a great extent on their own capital and deposits attracted in London. But now they are able to tap the pockets of the Indian people also. The same is the case with the Chartered Banks of Canada. They have branches or agencies in the United Kingdom, the United States of America, France, Spain, Italy, the West Indies, Cuba, Mexico, Central and South Africa and in the Orient also. They give every facility to the Canadian exporters to secure foreign markets. They enter the field and pave the way for trade expansion. Experts are sent to every country to study and report on trade possibilities. These Canadian Banks do not consider the branches as a financial burden. They have actually loaned outside of Canada sums up to \$183,600,000 (call loans in New York excepted) while outside deposits have amounted to \$318,200,000.¹ The same has been the experience of the British Joint-Stock Banks when they opened foreign branches in France.²

It must however be emphasised that all the Indian banks need not go about in pursuit of foreign exchange business but those that do enter into competition with the immigrant exchange banks would do well to remember that a foreign branch is an indispensable accoutrement for an efficient and successful transaction of this business and it is false economy to rely on the services of foreign agents.³ But those Banks that aspire to "do their bit" in the expanding of India's foreign trade and industries cannot really achieve anything unless and until they are directly represented in the foreign countries. Foreign Banks generally care more for the industries of their own country and usually do not perform their services with secrecy and impartiality. American industry and trade suffered largely by frequent disclosures through the medium of foreign banks. Hence certain American banks were encouraged to open foreign branches for collecting export bills,

¹ Vide H. Fisk, "The Dominion of Canada," published by the Bankers' Trust Co., New York, 1920 p. 50.

² The troubled conditions in Europe and its depreciated currency gave scope to these branches to secure good deposits. Balances have in most cases been transferred from uncertain currency into more certain currency and so the deposits of the branches of the English Joint-Stock Banks grew at the expense of local banks.

³ The Alliance Bank of Simla lost 32 lakhs on account of the mismanagement of the London Agents, Messrs. Boulton Bros. and Co., in 1920. It was forced to open its own branch later on.



honouring and issuing letters of credit and supplying current credit information for the benefit of American industry gathered from dependable sources.

But those banks that wish to confine themselves to the internal operations of loaning, overdrafts, discounting and aspire to mobilise our monetary resources should not open a foreign branch but keep clear of "foreign entanglements" as it will be a costly luxury to them. The unusual responsibilities of local deposit and commercial banking and legitimate satisfaction of its clients in the matter of banking accommodation must be thoroughly grasped by the foreign branches. The Midland Bank which is one of the Big Five of London systematically pursues this policy of keeping aloof from foreign deposit banking or even affiliations abroad.¹ The rest of the "Big Five" have girded their loins for increased foreign activity. In the words of Sir John Fergusson of Lloyds Bank the policy of these Big Banks is "to serve the world" and secure "a compact and co-ordinated all-British Imperial and World Banking system" as the *London Times* puts it. English Banks have their directors nominated to several affiliated foreign banks and they have acquired interests not only on the European Continent, but in South America, Australasia, Asia and Africa.

Bills of Exchange.

In the chapter on the Indian Joint-Stock Banks the necessity of employing uniform standard credit instruments preferably of the bilingual type has been pointed out. There has been no bankers' association enforcing or arranging and promoting the use of stereotyped forms of contracts, agreements, vouchers, accounts and other documents employed in banking business. It is indeed high time that this grave omission is rectified and the inland bills of exchange must become very popular as credit instruments.

¹ See the Chairman's Address to the shareholders at the Annual Meeting, 1921. Quoted from the Bankers' Magazine, London. But the other Banks belonging to the Big Five have opened banks which they control in France, Spain, and Belgium. But they realise that the limit of extension in the foreign fields has been reached

The Inland Bills of Exchange.

Financing of Inland Trade.

Sufficient attention was not drawn to the internal bills of exchange or inland trade bills till the year 1920 and the Indian banks never cared to finance internal trade largely by means of discounting trade bills. It is indeed true that *hundies* were used to a limited extent in this direction. But, broadly speaking, the system of cash credits was adopted in preference to trade bills. The advance is made on demand promissory notes signed by two or more persons unconnected with each other in general partnership with collateral security when necessary. The bulk of our mercantile business is transacted on this cash credit basis or "running overdraft" basis as bankers put it. An export merchant who wishes to secure banking accommodation to help him in the export of raw material would approach the banker and secure 20 or 25 lakhs as the maximum for the overdraft for a specified period. The actual accommodation however depends on the varying needs of his business. This affords him cheaper finance than any other method. He usually takes notes or rupees from the bank and purchases the product from the cultivator direct or through an intermediary and no bill is drawn on him or his intermediary by the cultivator. He sends the material out of the country and draws on the foreigner. This export bill is bought by the exchange bank and the proceeds would enable the merchant to pay the loan to the domestic bank.

What happened in 1920 and after.

The analogy of the Federal Reserve Board appealed strongly to the Babington Smith Committee which recommended the issuing of seasonal currency against export bills. When the Paper Currency Act of 1920 was passed the difficulties of basing the seasonal expansion of currency up to five crores of rupees on export bills were realised and in their place the internal bills of exchange or *hundies* were recommended as suitable cover.² Detailed regulations

¹ See Mr. M. M. S. Gubbay's Oral Evidence before the Hilton-Young Commission, Vol. V, p. 110.

² For a succinct summary of provisions for seasonal expansion of currency, see the Memorandum of Mr. A. C. MacWatters, submitted to the Hilton-Young Comm., Vol. II, Appendix 3, pp. 19, 20.

were issued on 16th February, 1922, to this effect. The rate of interest at which this seasonal currency was made available to the Imperial Bank was fixed at 8 per cent. The experience gained in this matter during the two busy seasons of 1922-23 and 1923-24 pointed out the necessity of raising this limit from five to twelve crores of rupees. The loans were also made available to the Imperial Bank as soon as the Bank rate rose to six per cent. and the whole amount was made available at a predetermined schedule of bank rates. But during the busy season of 1923-24 in addition to this expansion notes had to be issued by adding the British Treasury Bills to the extent of 12 crores in the Paper Currency Reserve. In September, 1924, it was announced that Treasury bills would be used as the basis for expansion of the P. C. R. and a change was also made in the issuing of loans to the Imperial Bank. Four crores were made available at six per cent. and the remainder at seven per cent. The Government also undertook to reimburse the Imperial Bank for the amount of loss sustained by it in "creating" bills to the necessary limit.

It is indeed disappointing to find that although self-liquidating bills of exchange were recognised as the basis for seasonal currency and due provision was made for it still no attempt was made to popularise these bills of exchange. The Imperial Bank had really to "manufacture" bills out of cash credits granted to the merchants and as a heavy stamp duty had to be paid on these bills the bank had to consent to bear this duty and although the Government came to the rescue of the Bank in this connection neither the Government nor the Imperial Bank undertook any measures to increase the volume of internal trade bills of exchange. The paucity of bills and the absence of an active discount market were realised by the advocates of the Central Bank of Issue but these preferred to run the risk of prematurity in starting this Central Bank. Although there is no other method so successful as the starting of a Central Bank, for the improvement of the discount market still other attempts must be made to popularise the drawing of trade bills.

Recommendations of the Bengal Chamber of Commerce.

The Bengal Chamber of Commerce in its memorandum drawn in September, 1924, drew attention to the necessity of increasing the

bills of exchange and suggested that the stamp duty should be reduced and the Government should willingly accept bills on stores purchased locally so that these would become popular instruments available for discount in the money market. Some of the more successful and large-scale manufacturing firms like the Tata Sons and Co., already adopted by this time the practice of drawing on the wholesale merchants and these were freely discounted by the Banks in the Calcutta Money Market. The Railway Companies should similarly accept bills drawn on them by tenderers of goods and as there is abnormal delay at present in the payment of money the seller of the goods can easily realise the money by selling these bills in the market. The present loss of interest would be obviated. However the financing of crop movements from the up-country to the port centres or the centres of trade was not done by the internal bills of exchange and unless this is done freely bills would not increase and an open discount market cannot be created in this country as in the case of the economically developed Western countries. Lack of knowledge of bank acceptance and adherence to old and time-honoured methods must have been the sole causes responsible for our backwardness in the use of bills of exchange.

Advantages of multiplying these Trade Bills.

The Central Bank's business is admittedly to finance the commercial banks by rediscounting their bills or, if open market operations are allowed, the buying of such bills of first class character is its legitimate function. To facilitate the free and successful functioning of the Central Bank these bills have to be created and a discount market dealing with these bills has to be developed. Secondly, the ordinary banks stand to gain much by discounting these self-liquidating genuine trade bills. One great difficulty in the matter of branch extension by the joint-stock banks is the non-availability of such liquid instruments as these short term trade bills. If enough scope exists for discounting such bills the bank would not feel it difficult to embark on a policy of branch extension in the interior. The general public would stand to gain by stabilised money rates. Thirdly, it is admitted by all that the system of providing currency on the security of bills of exchange tends to make it automatic and due

expansion and contraction takes place as fresh currency is issued against bills and as these mature there is automatic contraction of the same. It is in the interests of sound currency that these internal bills of exchange should be developed. Fourthly, it must be remembered that the Imperial Bank is becoming more and more censorious in the matter of the *hundies*. It is of opinion that *hundies* are becoming "very risky documents." One of the Governors of the Imperial Bank¹ is of opinion that "*hundi* brokers generally are not of a reliable character and they have the knack of disappearing in a monetary crisis. Any Bank which wishes to discount largely these *hundies* should take security from these brokers which should be confiscated if any loss arises out of these transactions. Endorsees of these *hundies* must also be of a solvent character." All these precautions are essential to check kiteflying by men of doubtful standing in the money market. Finally, the creation of an open discount market has to be faced and when self-liquidating bills can be converted into gold the holding of such bills by foreign banks might be brought about. Continental Banks are freely purchasing bank bills in the London Money Market and they do not buy even British Treasury Bills for they are precluded from buying bills unless they have two names.² Similarly foreign banks might care to hold our bank acceptances if we succeed in maintaining a free gold market and levy no practical hindrances in the matter of the export of gold from the country. Lastly the habit of drawing bills has to be encouraged and if the indigenous bankers are assured of rediscounting facilities at the hands of the Joint-stock banks and the Imperial Bank they would perform the original discounting of these bills and the cultivator can secure cash from the indigenous banker. These can act as the discount houses in this country. The indigenous banker would collect the proceeds of the trade bill from the drawee merchant who has already accepted it. He would have to be rewarded for this service and if his monetary compensation is higher than the

¹ See Sir D. E. Wacha, Written Evidence before the Hilton-Young Commission, Vol. II, p. 389.

² See S. E. Thomas, "Principles and Arithmetic of Foreign Exchange," 3rd Edn., pp. 96-99.

cost of securing a cash credit from a banker and moving rupees or notes into the interior this method of financing internal trade by means of drawing bills would never become an established fact.

Other Suggestions.

Now that my suggestion for a standardised inland bill of exchange drawn up in vernacular is accepted¹ it remains for the local Government to consider the reduction of the heavy stamp duty which has been suggested by the Hilton-Young² Commission and approved by the Government of India. As it is a matter for the Provincial Governments to decide it would take certain time to accomplish this needed change. To defeat the intentions of the law bills are drawn as Darsani or sight bills for these need not have to pay such heavy duty as the usance bill. There is always the implied understanding that the bill would be renewed. As the present tax,³ which bills other than demand bills would have to pay, ranges from 3 as. to Rs. 27 up to Rs. 30,000 and subject to Rs. 5 for additional Rs. 10,000 or part thereof in excess of Rs. 30,000, is nearly two times heavier than the tax prevailing in the United Kingdom,⁴ there is every reason for prompt reduction of this "nuisance tax" if the resources of the local Governments do not permit a complete abolition of the same. Barring the two provinces which have shown a deficit other provinces can hope to point out the way in this important direction.⁵

A change in the transfer of Property Act will enable the Bank to lend more on goods stationed in recognised warehouses or the borrower's godowns and this would lead to a free drawing of bills of exchange against goods and commodities on a greater scale than at present.

¹ See Rau, "Present-Day Banking in India," 2nd Edition, p. 110.

² See para. 116 of the H. = Y. Commission's Report.

³ See Article 13 of 1st Schedule of the Indian Stamp Act, 1899, and the amendment of 1910.

⁴ See the Todhunter Committee Report, p. 223.

⁵ The Mysore Government have done well in abolishing the Stamp duty on Cheques as well as Bills of Exchange.

A change in the law is also needed. The existing law with reference to the practice of the bills of exchange or *hundies* needs distinct change in favour of the banks. A negotiable instrument if originally drawn as a bearer instrument¹ must always continue to be so and should not lose its bearer character by any restriction or reservation by reason of subsequent specific endorsements.

Permission should also be granted to put in not only the adhesive stamp on the bill but a postage stamp. This would bring in difficulties in the matter of allocating the stamp revenue between the Postal Department and the Provincial Governments.² Some remedy should however be devised to overcome the administrative difficulty and allow the people to put a postage stamp on the bills. In America during the war time there was a stamp duty levied on the cheques and bills but they were understood to create a good lot of "nuisance"³ so that these "nuisance taxes" were the first to be abolished as soon as peace was restored.

Much capital has been made out of the illiteracy of the people. It is indeed true that a large number of our people cannot read and write. In Egypt the illiterate people kept deposit accounts with banks though they had no idea of how to write their own names.⁴ It is confidence that is essential in this vital matter. Lacking this there would be no free mobility of capital or any other use cannot be made of banking instruments if our joint-stock banks fail to conduct conservative banking business.

Even if the legend on the bill is drawn up in vernacular in a standardised form it would not work miracles in the matter of making these instruments popular ones. A legitimate campaign for the free use of these bills must be undertaken in this country. Merchants should be granted preferential terms by the sellers of

¹ See 27 Bombay L. R. 34 (1925) where it is held that a *hundi* drawn in favour of the payee or bearer and endorsed by the payee to a third person was considered to be no longer a bearer *hundi*. The Associated Chambers of Commerce have been trying their best to amend the law in favour of the banks.

² See the Report of the Indian Chamber of Commerce, 1926, p. 291.

³ See the evidence of the American Witnesses before the Hilton-Young Commission, Vol. V, p. 314.

⁴ See F. T. Rowlatt's Oral Evidence before the Babington-Smith Committee.

commodities and the wholesale merchants should grant preferential rates to retailers who are willing to accept such bills in lieu of obtaining credit on open accounts. Commercial banks should be granting preferential rates to merchants who finance themselves by discounting bills than to those who borrow on overdraft or by one-name promissory notes. The Central Bank itself would have to grant preferential discount and rediscount rates on trade acceptances.¹ In order to promote the custom of drawing bills some Central Banks are empowered in their charters to charge higher rates on advances than on discounts. The Reichsbank had to rehabilitate the Bill of Exchange as an instrument of payment in commercial transactions and the private discount market was reconstituted and the practice of bank acceptance was resumed once more.² By Aug., 1926, bank acceptances rose to 314 million Reichsmarks. But it has not yet assumed the pre-war size and extent. The charters of the Central Banks of Austria, Hungary, Czechoslovakia and the National Bank of Bulgaria prescribe that if the Banks' loans exceed the total of the bills held, the rate charged for advances is to be raised to one and half times the discount rate.³ No such provision was enrolled in the various Bills of the Reserve Bank—1927-28. The Imperial Bank would stand to gain if it freely rediscounts these trade bills, for these would be of use to it for rediscounting at the hands of the Controller of Currency. The limit of 12 crores is meaningless and should not be insisted upon. So long as genuine bills are offered by the Imperial Bank there is no reason for this limitation. This is not indeed so ideal a monetary reform as the one of a Bank of Issue considering the bills of exchange as part of its fiduciary currency, but in the absence of the best the next best would have to be resorted to to ameliorate the situation. There should be a vigorous campaign conducted by all parties, the Government, the Imperial Bank, the joint-stock banks, the shroffs and the co-operative purchase and sale societies to create these bills. By moral influence as well as

¹ Similar measures were advocated by the Kemmerer-Vissering Commission. See Report on the Reversion to the Gold Standard in South Africa, para. 49 (2).

² See Dr. H. Schaaf, "The Stabilisation of the Mark," p. 196.

³ See C. H. Kisch and W. A. Elkin, "Central Banks," pp. 133 and 134.

pecuniary inducement efforts must be made to increase the bills of exchange. It would create a healthy and desirable development in Indian monetary progress.

Dangers to be guarded against.

There is always the danger of a Micawber drawing bills for his household expenses on the fond hope that something would turn up to save him in the long run. It is the duty of the indigenous banker to see that such abuse of bills is not made. Such accommodation bills should be eschewed altogether and knowing the nature of the parties and their business it would not be difficult for the indigenous banker to know the bona-fides of the transaction. Anticipatory bills are freely drawn and discounted by banks in America but there is a very grave danger with regard to these kinds of bills. As our agriculture is subject to pests, diseases of crops and storms it might so happen that it would be as foolish as counting chickens before they are actually hatched. The practice of renewal of maturing bills should be frowned upon and the indigenous banker or the original discounting body should be aware of the fact that too frequent or continuous and indiscriminate renewals mean a departure from the strict principles of banking and might involve them in pecuniary loss in the long run. The period for which bills would run might undoubtedly be longer, for agricultural trading in the interior, devoid of proper means in the matter of conveyance facilities, requires longer time than any other industry. With such suitable safeguards as are outlined here the discounting of inland trade bills should be freely done and so long as bills up to certain limit are discounted by the banks there is no reason to suppose that the solvency of the banks would be threatened.

Mechanisation.

In most of the advanced countries the use of adding machines and other mechanical devices for performing the routine stereotyped work has become an accepted feature of banking business. In order to facilitate the work of the adding machines the big banks number their

branches and the suggestion has been mooted that banks should be numbered so that adding machines can now be freely used in dealing with the cheques.¹ Such mechanical devices would not lead to an obsolescence of brains of the bank clerks but would tend to free them from the routine duty so as to be in a position to release their mental faculties for better use. There is no reason why Indian banks should lag behind the other banks in this respect. The adding machine is used to facilitate the clearing of cheques in the local Clearing House. Some photographic apparatus can be used for taking number of copies of documents which are to be filed in the banking offices. Ledger entries in some of the English Banks such as Messrs. Coutts and Co. and Messrs. H. J. Schroeder and Co., are made by machinery and in the American banks the ledgers are written up by the Burroughs Adding Machine. There are different devices for copying letters and documents, for sorting, arranging and filing vouchers, for stamping work of all kinds, machines for subtracting and multiplying and preparing statements and for sorting and counting coins.

Although the advantages of using machinery for routine work is understood, the real reason why no move in this direction has been made is that clerical labour in this country is very cheap and the cost of the imported machines is undoubtedly very high. But in the interests of quick and accurate work the use of these mechanical appliances should be encouraged. The Indian Railways use accounting and tabulating machinery in the compilation of statistics and they are second to none in their equipment. As an increased volume of account work can be turned out by machines without excessive additional cost, they must be used by our Joint-Stock Banks on a larger scale than at present.

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CHAPTER XVII.

BANKING LEGISLATION.

The Rationale of Banking Legislation.—Foreign Banking Legislation.—Special Circumstances of India tending towards Legislation.—Suggestions for Banking Legislation.

The Rationale of Banking Legislation.

Banking is of high antiquity and our ancestors were familiar with banking credit. At least history credits them with that knowledge. Archeologists have discovered clay tablets of credit that were in use in Assyria.¹ Students of Manu, the famous Indian law-giver are familiar with his well-known laws regulating the use of credit. The Athenian money-changers did business somewhat closely akin to modern banking business. Xenophon anticipated the idea of a bank but he was too far ahead of his time. In the *Argentarii* of Rome can be seen the nearest possible approximation of a modern banker. The barbarian invasions of Rome and the ensuing unsettled conditions of Europe during the Dark Ages must have prevented the early development of banking business.² During the middle Ages the money-changers of Italy revived their business and the Jews, thanks to the persecutions of all continental countries, perfected the beautiful bill of exchange. The successful lead of the Italian merchants and their religious zeal to collect the Papal dues while acting as the emissaries of the Pope in the continental countries led to a very extensive use of the bill of exchange. To Italy belongs the credit of having founded the first banks, *viz.*, the Bank of Venice (1167) and the Bank

¹ See Collin's Banking Law. Collins also says that one "Egibi and Co." acted as the national bank for the Babylonian monarchs. These baked clay tablets are preserved in the British Museum.

² According to the Roman Law each family had to maintain a ledger in which the head of the family had to keep a record of borrowed money or money lent, all profits or losses or any disbursements of any kind. These ledgers were the only legal evidence in a Court of Justice and it is from this custom of book-keeping that the modern credit system has developed.

of Genoa (1345). The Italian money-changer, the Jewish money-lender and the Lombard-street financier are the important connecting links in the banking chain. With the advance of centralisation in commerce and national life the necessity for public banks arose. The development of manufactures and rapid growth of international trade led to large-scale banking and to-day banking business is regarded as an honoured profession and it has received such a wide and varied form that it is hard to believe that our ancestors were familiar even with the rudiments of banking credit.

If banking business is of such hoary antiquity and if state regulation of bankers and banking credit was well known to our ancients as evidenced by the Athenian regulations, the Code of Manu and the Justinian laws¹ the modern state ought to feel ashamed at the perfunctory manner in which it attempts to control the modern banking business in the interests and well-being of the nation.

Besides this historical justification there is another cardinal reason why the state should control banking business. The modern banks can make or mar the future of a nation. With the entire credit mechanism of the country controlled by it, with the whole floating capital of the nation deposited in its hands, with the nation's material future entrusted to it and with "the fate of the nation lying on its lap" the modern banking system is indeed a vitalising force, which, if exerted in the right and proper channels, is fraught with immense possibilities. With a judicious selection of their customers and with timely loans to them they can build up the manufactures of a country and direct capital and labour to the most productive channels. By creating thriving industries they can add to the national wealth of the people and bring contentment to the wage-earning labourers. They can accomplish all this and more.²

But their power to do harm in case of misdirecting capital, encouraging speculation and wrong investment is no less considerable. What the State aims at by wisely directed banking legislation is to maximise the advantages of sound banking and help the banks to better

¹ When the learned writer MacLeod said that "Banking in the modern sense of the term did not exist before 1840," he probably only meant this thing.

² For an exhaustive treatment of this subject see my "Elementary Banking"—section entitled "Economic Services of Banks."

perform their task. Modern banking is a quasi-public service to be watched and properly regulated. The anxiety of the state is to see that banking accommodation is being extended to all the deserving persons on equal terms. Banks are public utilities intended to distribute their resources mainly with an eye for the public benefit.

The failure of a bank creates a vicious circle and ruins several people. Though the state recognises the impossibility of legislating to prevent failures yet it attempts to prohibit banks to do business of an unsafe character or alien to legitimate banking business.

The state while passing laws of a restrictive nature forbidding the banks to do as they like is not altogether unmindful of the interests of the bank. It recognises the social services of the banks and gives them special facilities. The special laws about the negotiable instruments and other concessions shown to them as the general lien of the banks, the law of Estoppel and the Banker's Book Evidence Act are an evidence of this grateful recognition. While treating them very leniently the state does not forget to restrain effectively their power to do harm to the public by their own indiscretion. General laws are passed so as to attain uniformity and prevent favouritism.

Banking legislation extends from the Central Bank right up to the ordinary joint-stock banks. The Central Bank is always made to work under special provisions incorporated in a separate charter. The ordinary joint-stock banks are incorporated under another law common to all of them. Private banks escape vexatious government control in almost all countries. Their importance is however dwindling day by day. So long as they are under able financial guidance they earn the gratitude of their country. But the continuity of such able financial guidance is not assured in all cases and many ignominious failures have occurred in the past. Hence private banking is diminishing in importance. In England¹ and America public opinion is decidedly against them and they are virtually forced to amalgamate themselves with other concerns by virile competition

¹ Walter Bagehot says, "there has probably very rarely been so happy a position as that of the London private banker and never perhaps a happier." This remark might have been true in his own time but to-day the demand for greater publicity and greater security for associated capital is working against the private banks.

prevailing in the money market. Here as elsewhere the case of India forms a notable exception. In India the private bankers (indigenous bankers as they are styled) are going on as usual but the growth of the Co-operative Credit Societies is leading to the narrowing down of their clientele. The education of the masses, the general stability of the joint-stock banks, a wide diffusion of sound banking facilities and the general apathy shown by the indigenous, *i.e.*, private bankers towards industrial development will certainly tell their own tale in the long run. These indigenous bankers, unless they become more progressive and adopt the best features of joint-stock banking and adapt themselves to the changing needs of our society, are bound to disappear in our country also. But they are still a powerful element in our banking system to-day.

The case of joint-stock banks is different. They are under able financial guidance and influential directors can mould these institutions into such a shape as to bring about the greatest good of the greatest number of people in a given society. The necessity to earn profits must force the banks towards progress tempered with caution.¹ Hence joint-stock banks are on the increase everywhere and as the banking blue book indicates they are increasing in numbers in our country also.

The main reasons why the state is so solicitous to procure sound banking conditions have been set forth already. But something more must needs be stated to explain why joint-stock companies conducting banking business are differentiated from other joint-stock companies and treated separately. One law does not suit both of them because the banks are lending institutions while joint-stock trading concerns borrow money for their business. Secondly banks create and protect credit; while other joint-stock companies

¹ Lord Overstone writing in 1832 says, "joint-stock banks are deficient in everything requisite for the conduct of the banking business except extended responsibilities," Bagehot commenting on this statement says that "the bankers of Lord Overstone's time lent much to private individuals from whom no security could be obtained. The banker acted on the judgment of discretion, the sense and solvency of those to whom he lent." But now the banks have ample material to judge the standing of the borrower. Credit information of a high order can be obtained easily. It is now possible to scrutinise the balance sheet of the borrower, and bearer securities can be taken as collateral for covering loans.

receive credit and exploit it. So banking companies have special safeguarding rules to protect and help them.

While usually one law is considered sufficient as regards the process of formation of trading as well as banking companies, the latter are subject to additional legislation of a very detailed character. Very careful prescriptions of law extending to every important item of banking business are laid down in order to bring about full trustworthiness of these banking companies. The amount of capital, the accumulation of the reserve, the character of loans and discount business, the nature of cash reserve and its proportion as against the demand liabilities of the bank and the very quality of the investments of these banking companies are all subject to stringent regulations for the following reasons.

✓ The capital of a bank is the money subscribed by the shareholders. It stands virtually as a guarantee to the customers of the bank inspiring them with confidence. Banking business is purely a question of mutual confidence between the depositors of the bank and the banker himself. It is very often known as the "Big confidence game." Banking business consists in lending other's money and, as Lord Overstone says, "banking business is a business of the brain with other people's money." A paucity of capital will not enable the banking institution to execute its tremendous task of responsibility and trust efficiently, hence the legal regulations against inadequate banking capitalisation. In the case of new banks, there is always an impairment of capital for the first few years as expenses run in excess of interest collections and unless there is a large amount of capital actually paid up at the start, it is difficult to meet with success.

Legislators wish to regulate not only the amount of capital required for the starting of a Joint-Stock Banking Company but they also insist that a due proportion, say one-half or one-third, of the subscribed capital should be paid immediately at the start and the balance to be paid within six months at the utmost. Their aim is to prevent the banking company from being handicapped to any extent by virtue of its meagre capital. (A large capital also renders unnecessary "touting" for business to get profits or canvassing for depositors by paying a high deposit rate.)

Coming to the reserve, the State aims to compel the banks accumulating a decent reserve in order to help the bank in its operations. The reserve is virtually the shareholder's property and can be locked up with impunity and the greater the reserve the greater is the confidence inspired in the minds of its customers as regards the utility of the banks to discharge their liabilities.

A large reserve acts as a buffer receiving all sudden and unexpected shocks such as a great depreciation of assets for which no provision has been made and bad losses greater than the amount of profit earned during the course of the year. The presence of a large reserve on such occasions saves the original capital from being washed away by these unforeseen happenings. It may be utilised for the equalising of dividends.

It is by loaning that a bank confers its greatest blessings on society and its business. The strength and safety of the bank depends on the character of the loans it grants. The bank has not only to select judiciously its customers but it must not commit the fatal error of lending too much of its loanable money to any individual firm or undertaking. The object of the legislator is to see that the bank distributes its risks over several concerns or individuals of the most unimpeachable honesty, financial rectitude and business capacity.

Another object why loans by banks to its officers and directors are restricted is to see that no greater line of credit is granted to them than they can obtain from any conservative banker. Even in the matter of discounting business the anxiety of the legislator is to curtail the freedom of bank from accepting anything except first class paper or tying up their money in transactions of a spurious character.

Legislators wish to prohibit the bank from lending on the mortgage of real property as it would lead to a locking up of the short-term deposit money in long-term loaning. Hankey, a practical banker, says, "the commercial banker has to realise the enormous difference between a bill of exchange and a mortgage of real property." The difficulty of ascertaining the true ownership of these kinds of real property as houses and land and the legal restrictions that are attendant on the transactions of such property preclude them from the

commercial banker's choice. He has neither the time nor the ability to assess their value carefully and loan on them.

Legislators realise that a wise management of the loaning business conduces to the stability of the bank and enables it to pull on with a small cash reserve and does not lead to an unwise expansion of credit.

The cash reserve of the bank is not only the foundation of any credit that can be created by it but is an insurance fund against risks. It enables the bank to meet any unusual and extraordinary demands made on it by the depositors. The object of regulating the cash reserve, fixing its dimensions and even prescribing its actual composition is to enable the bank to better perform its task and as the bank is always saddled with large numerous "demand" deposits to be paid there should be a guarantee that it can meet the depositor's call. The desire to earn profits is very natural and the tendency to reduce the cash reserve almost to the breaking point or "apprehension limit" as Bagehot puts it has to be curbed by laws.

It is true that a legal limit to the cash reserve tends to make it inelastic and any law prohibiting its free use in case of rare emergencies is meaningless. As Mr. Robertson says, "an iron ration which you must not touch even in the throes of starvation is something of a mockery." It generates a sense of false security. By keeping the prescribed limit of cash reserve the bank may think that it has done everything it has to do. But laws should be so framed as to permit a free use of the cash reserve and the fact that it is kept and that it enables the bankers to meet some portion of their liabilities is a source of confidence. It limits the field of disaster that may be brought about by injudicious or adventuresome banking. Instead of overwhelming and complete bankruptcy there is something which enables the bankers to dole out to its creditors.

Successful banking is virtually dependent on a careful management of the cash reserve. While recognising that "the cash reserve is dead money and makes no contribution to the dividend whatsoever" as Professor Foxwell puts it, the bank managers should possess a cool head, sound judgment and a resourceful mind. By constantly adjusting their discount rate they should bring about satisfactory conditions always. Very few banks realise that it is better to err on the side

of caution and provide a large cash reserve thereby making a part of it idle rather than be adventurous with a smaller cash reserve. The banks should not rely on their ability and management 'to muddle through somehow' as Lord Rosebery puts it. To avoid failure is far more important than to keep up high and precarious profits. As Bagehot says, 'adventure is the life of commerce but caution if not timidity is the essence of banking.'

As regards investments, that is, the banks' holding of gilt-edged securities, the object of the legislator is to make the banks invest their funds in such a way as not only to yield profits but see that they are at the same time liquid. Only first class securities are to be held and these should possess absolute strength and safety and be easily marketable with the minimum trouble and risk of loss. As several of the ordinary industrial securities do not possess these coveted features, the banks are prohibited by law to invest their funds in them.

Publicity.—In addition to those laws hampering the freedom of the banks almost in every kind of their business the state insists on banks' publishing their transactions periodically. Although some of the banks may report to the pernicious practice of window-dressing at the time of publishing their balance-sheets yet much can be gained by publicity. The furnishing of a well-informing balance sheet which actually unfolds the tale of progress and increase of business is by itself the most successful method of attracting customers to the bank. The joint-stock banks of other countries have realised the manifold advantages of publicity and they are coming forward of their own accord to furnish all details of their business transactions.

This is the *raison d'être* of all banking legislation and there is ample justification for the State regulation of banking business. The State knows full well that the banks cannot be made safe and well-managed automatically by means of its laws and regulations. It realises that no system of examinations can be a perfect one. It always grants considerable latitude in the matter of loans and knows clearly that to impose a dull uniformity without paying any due heed to the changing conditions of different localities, will be of no avail. Hence it is wise enough not to descend to details. It is fully

conscious of the fact that honesty, integrity and capacity cannot be obtained through the process of legislation. It cannot and does not aim to legislate so as to secure people from their own lack of business qualities. Such is the psychology of the bank-controlling mind.

It is indeed difficult to explain the absence of any banking legislation in our country. It cannot be attributed to any lack of knowledge in this particular sphere. Our semi-state banking institution which was recently created (*i.e.*) the Imperial Bank of India is controlled by the State. Its position does not cause any great anxiety, for the State in the fullness of its banking wisdom retained the old rules of the Presidency Banks' Charter Act of 1876. It is only the position of the newly started and small joint-stock banks that is totally unsatisfactory. The wonder is why the State has not thought it wise on its part to fetter the hands of these joint-stock banks by well-drafted regulations.

Another instance which goes to prove that our State possesses a high conception of its duty towards banking institutions, occurred quite recently during the days of the banking crisis of 1913-18. It volunteered pecuniary help to all the sound banks but the old Presidency Banks through whose medium and intervention the State wanted to help did not rise equal to the situation and this episode forms one of the worst spots in the dark pages of their history. They cast to the winds the expansive theory of banking which Central Banks generally pursue during the period of a crisis.

Again their policy of welcoming all foreign banks and extending an open door to them resulted in much good to our country.¹ These have not only popularised banking business in our country but are the standing monuments of a conservative policy for slow, sure and steady progress in banking business.

But the *non-possumus* attitude of our State towards the smaller and newly arisen joint-stock banks is hardly creditable to it. The existence of some kind of laws, good or mediocre, would have prevented several failures or at least would have mitigated the intensity and severity of our banking crisis.

¹ Spain resented the intrusion of foreign banks and passed legislation against such intrusion with the result that the Spanish branches of the London County, Westminster and Parr's Foreign Bank, Ltd., had to be closed.

Foreign Banking Legislation.

The cardinal reasons actuating the minds of the legislators while framing restrictive laws on the operations of the banking companies have been set forth in detail. It is not the Central Banks alone that are regulated but banks of deposit also are subject to State regulation. Note-issue is generally concentrated in the hands of the Central Bank and it is everywhere the subject of detailed regulations. The banks of deposit manufacture cheque-currency which constitutes the important medium of payment in advanced countries and ninety-five per cent. of the business transaction of modern societies are conducted through the principal means of 'the cheque' and it is this reason that must have forced the legislators to turn their attention towards the banks of deposit. This service must be rendered economically, efficiently and honestly by the deposit banks and hence their regulation.

While all countries have deemed it wise to control their note-issuing banks, if any, and their national banks they differ in their treatment of the deposit banks. The cases of Canada, America and India are quite unique.

Canada furnishes a splendid example of a decentralised banking system buttressed as it were by provokingly detailed laws.¹ In a decentralised system of banking where many individual banks exist with no recognised head, banking legislation is of a minute character and much pains are taken by the State to avoid failures. In addition

¹ The Dominion of Canada has at present eleven Chartered Banks with about four thousand branches and the official regulation of banking by the Federal Parliament is a noteworthy feature. The Canadian Bankers' Association supervises the issue of notes and reports to the Finance Minister all over-issues and it takes charge of suspended banks. Each Chartered Bank is a member and its quarterly journal is of an excellent quality. Banking is a real profession there with its own policies and traditions. The trained banking officers have a thorough grasp of the credit situation. In spite of these facts the Federal Parliament revises decennially (next revision is to take place in 1933) the Charters of the Banks which are liable to amendment at any time in the interests of safety and public convenience. The most recent instance, that can be quoted, of its anxiety to safeguard public interest is the passing of the Federal Farm Loan Act thus designing a separate machinery for the helping of the Canadian Farmers with long-term credits needed for their agricultural development. (See L. M. Mintey's article on the Canadian Federal Farm Loan Act—Journal of the London School of Economics, 1922, Oct.)

to State regulation the banks mutually agree on a common course of action and control themselves by the decisions arrived at in discussions of the clearing houses or at meetings of the Bankers' Association. Thus State direction is aided by mutual control and efforts are always made to help sound banks in times of emergency.

Coming to the details of banking legislation in the United States of America one finds the State laws to be so varying in nature and different that no adequate idea can be gained of them in such a concise chapter as this.¹ The laws regulating the National Banking Companies are more uniform, rational and convincing.² Firstly, the capital of a bank is graded and regulated according to the inhabitants of the place. For 50,000 inhabitants the minimum capital of the banking company is fixed at dollars 200,000. Nextly the National Bank Act requires $\frac{1}{10}$ of the net profits to be set aside each year till a reserve fund is accumulated to $\frac{1}{4}$ of the capital of the Bank. As security for the depositors the National Bank Act insists on the double liability of the shareholders. As for note-issue any national bank may invest the whole of its capital in Federal bonds and notes up to the par value are entrusted to the bank by the Comptroller of Currency and any National Bank issuing these notes must maintain a 5 per cent. redemption fund of the face value of the circulating notes in the hands of the Comptroller. The Act prohibits the Banks to lend on real estate. No loan can be granted to a single individual above 30 per cent. of the capital of the Bank. An excess of the amount is permitted in case the bank lends on bona-fide bills of exchange and commercial paper owned by the customer. The National Bank Act requires 15 to 25 per cent. of all deposit liabilities as cash reserve.³ In case it falls below this legal minimum discount business

¹ The State Banks and Trust Companies are given a wider scope of activity and are subject to close supervision of the State Superintendent of Banks. National Banks are now subject to federal legislation and are controlled by the Controller of Currency.

² For Governmental regulation of banking prior to 1860 see H. P. Willis, "American Banking," Chs. XIII and XIV. A good idea of the legislation affecting the State Banks and National Banks can be obtained from the Proceedings of the American Academy of Political and Social Science, Vol. I (1911, pp. 286 to 290).

³ The various National Banks in the different American cities are divided into three classes: (a) National Banks in the Central Reserve cities (Chicago, St. Louis and New York) have to maintain 25 per cent. cash reserve in lawful money. (b) Reserve City Banks (about 50 National Banks situated in towns whose population was not less than

has to be stopped. Besides these rules banks are subject to periodical examination by the bank examiners specially appointed by the Comptroller of Currency. The National Bank Act requires the submission of five reports of their banking operations during the course of a single year. The Comptroller of Currency is invested with general supervising power over the banks and the charter of incorporation of each bank is to be renewed once in 20 years. The Indian readers will no doubt be staggered at the vast output of this banking legislation.

In England, the home of the laissez-faire theory, similar supervision was never devised, nor would it have been tolerated by the banks. The Bank Charter Act of 1844 recently revised in 1928 still governs the working of the Bank of England and its note-issue. The other banks are incorporated under the various company laws and beyond this there is no special legislation as regards banking business in England. English Banking mainly evolved on the principle of every man for himself,¹ while other Governments considered it wise to throw their shield around every bank. According to Hartley Withers 'it is not good laws but good bankers that produce sound banking.'

50,000 inhabitants) must keep 25 per cent. but half of it might be deposited with National Banks in the Central Reserve cities. (c) National Banks of the third class have to keep 15 per cent. of cash reserve and of this $\frac{2}{3}$ can be deposited with the National Banks of the Reserve cities. This rigid reserve requirements of National Banking Act 1863 have been modified to a great extent by the Federal Reserve system introduced by the F. R. Banking Act of 1913. The proportion was fixed at 18 per cent. instead of 25 per cent. in Central Reserve cities, 15 instead of 25 per cent. in reserve cities and 12 instead of 15 per cent. elsewhere. Only one-third of the reserve was to be in cash and the remainder could be deposited with the Federal Reserve Bank. This Act was amended in 1917. The whole reserve was to be on deposit with the Federal Reserve Bank, the cash was left to the unfettered discretion and the proportions are reduced to 13, 10 and 7 per cent. Only 3 per cent. is required against time deposits while previously 5 per cent. reserve had to be kept.

This peculiar law about the reserve helped the process of financial domination of Wall Street over the rest of the country. The National Banks are permitted by law to keep their reserve outside and the New York bankers absorbed these deposits to a great extent and utilised them in financing the dabblers of the stock exchange. But the Federal Reserve Act brought about the needed financial decentralisation.

¹ See the late G. H. Pownall's inaugural address as President of the Institute of Bankers, 1916.

While the English economists and bankers object to a normal amount of control, help or interference on the part of the Government it must not be construed as an aversion to State help during abnormal times. They incline to the opinion that the Government should stand "behind the banks" and protect them on emergent occasions. Whenever a crisis appears the Bank of England is expected to increase the note-issue and take care of all the sound institutions by providing them with note currency. Even before the passing of the Currency and Exchange Act of 1914 in England, the quasi-legal understanding in the British community was that the Bank Charter Act of 1844 would always be suspended during exceptional times of grave anxiety. The recent Bank Note Act of 1928 has given the Bank of England full freedom to secure elasticity to satisfy legitimate demand for credit and render impossible at the same time monetary inflation.

During the period of the recent war new measures were adopted to save the banking situation in almost all countries. In England steps were taken to protect the joint-stock bankers, acceptance houses, bill brokers and the stock brokers. In short the different constituent members of the money market were supported. Such was the paralysis with which business was affected. Neither the usual method of suspending the cash payment as was done during the eventful years of 1797-1820, nor the mere suspension of the Bank Charter Act of 1844 as was resorted to during the years of 1847, 1858 and 1866 would alone have saved the situation.¹

The Government of India follows closely the footsteps of the Government of the United Kingdom. The English bankers, *i.e.*, the founders of the Agency Houses² taught joint-stock banking business to the Indian people. As Prof. Dicey says, "the Englishmen carry their Common Law with them wherever they go" and English bankers in India can hardly be expected to be more docile in

¹ It is not the aim of the author to describe the causes of the crisis in 1914 nor treat the various remedies in detail that were taken to remedy the situation. For a graphic description of the crisis, Hartley Withers's book "War and the Lombard Street" can be consulted and for the various measures adopted an authoritative account can be obtained from A. W. Kirkaldy's *British War Finance*.

² Many of them were the Directors of the Bank of Bengal during the year 1813-1820 and effectively shaped its policy.

submission to banking laws. As a result of this fact general banking laws regulating banking business are few even now in India.

The Government of India circularised¹ the various provincial governments inviting suggestions for banking legislation in 1913 but with the advent of the late war the question was practically shelved. The different Chambers of Commerce were approached and the majority of them inclined favourably towards banking regulation on broad and general lines. From a recent circular² one learns that the Government of India wishes to pass legislation making it compulsory for every Indian joint-stock bank to publish monthly its own operations according to an approved form of balance-sheet. Beyond it they have declined to proceed further.

Even China, "the home of strife, of flouted authority, of widespread disintegration and of national penury," is making rapid strides in the matter of her banking business. Before the recent war banking business was nothing but a pawn-broking profession. The native bankers never helped the Chinese Government with loans intended for the development of railways, industries or national development and reorganisation purposes. But with the closing of the foreign markets in the recent war the Chinese Government had to cajole the leading native bankers and quite a profitable business was done by the Pekin banks in financing the Government at 15 to 20 per cent. rate of interest. There was then a rush for banking business and various guilds are now financing themselves by starting banking firms of their own. So to-day one finds Silk Agricultural and Labour banks. Chinese banks were established even in foreign countries, *e.g.*, Sino-French bank, Sino-American bank, Sino-Italian bank, Sino-Belgian bank, Sino-Danish-Norwegian bank. The starting of the banks had an appreciable influence in bringing about peace, order and tranquillity.³ The Chinese Mandarins and the medal-bedecked

¹ Letter No. 6905, dated 22nd August, 1919. The Department of Commerce.

² Letter No. 807, dated 17th November, 1920. The Department of Commerce and Industries.

³ Twenty years ago there were only 2 or 3 sound banks but there are now more than 100 of them, with more than 350 branches. For 41 banks which reported details to the Shanghai Bankers' Association in 1921 the total assets amounted to about \$400,000,000 gold and the deposits amounted to about \$210,000,000 gold. Thus the situation is a great improvement over conditions prevailing in 1900 and the present Commission for the

Tuchun have given up civil war as their profession and are undertaking banking business. These newly started ventures are agitating for legislation to help them and smooth their progress. The second united Chinese Bankers' conference at Tientsin passed resolutions inviting legis'ation in the matter of issuing notes, bills and cheques. It pleaded for the abolition of the tael and recommended the use of the dollar in its place.¹ It pleaded for the abolition or at least exemption of transportation fees on all bank notes and specie payment from one bank to another. It pointed out the necessity of stopping the minting of old silver and copper currency. It agitated for the recognition of the existing Clearing Houses and Banking Association in the country. It recommended the starting of a bureau of information to ascertain the financial standing of business firms on the lines of the Dun and Bradstreet and give them an official rating as the American reports do, or failing this, to establish an enquiry bureau on the model of Stubbs or Seyd or Shimmelpfeng. It requested the State to establish a standard technical terminology for banking business. The foreign bankers' Association of Shanghai is closely co-operating with the Chinese Banks to secure the above reforms and an International Banking Association is to be started shortly. Quite recently the Central Bank of China has been created to operate as a national institution and is doubtless meant to help the reformation of the Chinese currency situation.

Although India does not stand so disorganised and bankrupt and is not in such a morass of helplessness as China, the Indian joint-stock banks can emulate the zeal and enthusiasm shown by their Chinese contemporaries.

It was only recently that Japan thoroughly overhauled her banking system and all the ordinary banks and savings banks have been subjected to legislative enactment. The same has been the case in the reorganisation of the banking system in Poland.

adjustment of national finance is attempting to devise measures for the amelioration of the public debt, the preparation of a budget and the adoption of a sound currency system.

¹ The Green Shihk'ai dollar is circulating all over the country. The old time dependence on French, Spanish and Mexican coins is no longer felt.

Special Circumstances of India tending towards Banking Legislation.

Several prominent non-officials in this country suggested legislation for the better management of banking business.¹ Discussion keenly centred round this pivotal point after the failures of the Indian Joint-Stock banks. There is a consensus of opinion in this matter and the necessity of enacting sound legislation as a possible safeguard against further failures and a repetition of past disasters must be acknowledged by the bankers and recognised by the Indian public.

At present there is very little banking legislation. The Government of India committed the fatal blunder of requiring all companies, banking as well as trading concerns, to be incorporated under the same act, *i.e.*, the J. S. Companies Act of 1913.² They have shown a

¹ Every witness before the Indian Industrial Commission who was competent to speak on banking matters advocated legislation. The only solitary exception is Mr. Nandlal Puri who considers the Joint-Stock Companies Act of 1913 as an efficient and comprehensive measure. The Hon. (now Sir) T. Smith of Allahabad wanted the definition of the word "bank" and a limitation of its use to protect ignorant people. Sir Stanley Reed in his evidence before the Babington Smith Committee wanted that all small banks should be closely supervised by the Government. G. F. Shirras comments on this fact and suggests the formation of a banking Committee evidently with a view to overhaul the whole system and rebuild the banking structure with a statesman's hand.

The subject of banking legislation also received great attention during the Indian Industrial Conferences of 1913 and 1914. But there was no thoroughly conceived plan of reform advocated by any of these reformers.

² Even in the matter of the J. S. Companies there is considerable laxity in the observance of the 1913 Act. Even though breaches of law are detected and prosecutions launched, summary punishments for these lapses from the ordinary commercial morality are not usually imposed on the offenders. Registered banking companies are often liquidated and then almost immediately registered again under new names but with the same directors as before. Leniency in the matter of enforcement of the Act is no encouragement of Jt. St. enterprise and the interests of the shareholders should always be safeguarded. The attitude of the Government of the United Kingdom towards the J. S. Companies would undoubtedly be changed in the light of recommendations of the Company Law Amendment Committee. It is proposed therein that no Company can be registered with the name "Bank" or "Banking" without the consent of the Board of Trade. It has also recommended that provisions as to directors' liabilities should be extended to the auditors of the Companies. It objects to the practice of articles which exempts directors of Companies from legal liability for negligence or misfeasance. There are other excellent recommendations referring to the practice of the Jt. St. Companies in England which the Indian Government would do well to note. (See the Journal

deplorable lack of banking ideals in permitting the authorised capital of a bank to be much larger than its paid-up capital thus tolerating inadequate banking capitalisation. An undue prolongation of the paying-in of capital is another short-sighted policy allowed by the Government. The paying of dividends out of actual capital or when a substantial reserve has not been accumulated is not prohibited. The character of bank loans has not been defined. The granting of too large a proportion of the loanable funds of a bank to individual borrowers is also permitted. No definite cash reserve is stipulated. The advisability of legislating to get a better security of deposits has not been considered. There is not the least semblance of an independent bank examination on the part of the Government or of the Clearing House. Not much of publicity is insisted upon.¹ Only the loans of a bank have to be divided under certain headings and detailed information has to be given on this point.² There is no power to call for any special return from the banks.

Special Reasons for Banking Legislation.

Banking business conducted on the joint-stock principle is quite new to the Indian mind. Having become familiarised with the stable private banking houses of the indigenous bankers, the Indian people in the smaller cities and places view the joint-stock banks managed by outsiders with some apprehension. The recent failures made them all the more suspicious. Even though there are only 28 banks with their capital and reserve fund above Rs. 5 lakhs and a host of smaller concerns, there is no reason why our banking regulations should not be stiffened.

General banking laws are not required to provide the proverbial 'strait-jacket' for our banks but only to inspire the public with

of the Institute of Bankers of the United Kingdom, March 1927, pp. 136-139.) Now that the Indian Companies Act is going to be revised it is worth while to stiffen the regulations in several directions.

¹ The Registrar of the Joint-Stock Companies has to be furnished with a balance-sheet of the Company annually along with the Register of shareholders. *Vide* Indian Companies Act of 1913.

² The particulars required by the Act of 1913 are given in Form G, Third Schedule, Indian Companies Act of 1913.

confidence. Confidence is the breath from which the banks draw their very life. While giving the necessary freedom to the banks to make their business flexible and adaptable to the business needs of the community, the general banking laws should forbid the banks to venture out on other fields than banking.

The Government should take the initiative in this matter. Neither the fewness of our banks, nor the fact that they are managed by trained Westerners must stand in the way of official regulation of our banking business. The apathy of the existing Indian joint-stock banks is hardly creditable to them. So long as they are doing sound business no official regulation hinders them. On the other hand it will help them to a great extent in creating confidence in the minds of the people. Education of the masses as to the utility of the banks and their services is a slow process and it takes several years to create that confidence in the minds of the Indian people. Official regulation will accomplish the same in a shorter time as the Indian people have a touching belief in the potency of official law.

It is true that "there is no legislative road to banking paradise" as one English banker puts it. Legislation may not be the panacea for any of our banking ills. Government control and inspection may not prevent banking failures. It is indeed true that many of the National Banks of the United States of America failed in spite of detailed banking laws and rigid Government control. It is quite likely that the machinery of Government will not produce a competent staff to supervise the various banks in an effective manner. It is undoubtedly certain that control emanating from within by the depositors, by the shareholders and by the customers will be more effective and valuable than control from without by Government-appointed Examiners.

Good directors, good servants and good auditors can accomplish more than any sort of ideal regulations. However, it must be recognised that much benefit will result from sound banking laws. The newly started banks can derive invaluable aid from these restrictions. Some banks finding nothing to hinder them in the shape of laws may become 'adventuresome' and tie up the depositors' funds and come to grief. By all means the banks should be progressive and display the pioneers' willingness to turn their hand to whatever comes in their way. They should adapt themselves to the changing

requirements of their customers but this does not mean that they should play fast and loose with other peoples' money.

The Government, so long as it defines the nature of business that a bank has to do and imposes ordinary restrictions which the banks themselves have to arrive at for the proper conduct of their business, should be regarded as doing its legitimate duty and cannot be said to transgress the freedom of bank officials. The Government should see that thrifty people do not suffer by entrusting their savings to bogus banks. Only the Government should not make the banks instruments of its own and incline to the pernicious idea that "the best way of creating money is to borrow it."

Government legislation may be unnecessary in the case of highly advanced countries where the banks themselves understand their legitimate business and where the public are alive to their responsibilities. But in backward countries where banking ideals are not crystallised legislation is not unnecessary. The banks will be new to their business, the public ignorant of their duties and many a pitfall can be avoided by following the straight and simple rules laid down by the Government. It is folly to leave everything in amateur hands to regulate their business by the quantum of their own limited experience or inadequate bye-laws they may pass for themselves.

Again Government legislation may be unnecessary when all the directors of the banking companies actively participate in the management and framing of the bank policy and when the directors or managers are not allowed to participate in the management of other companies at the same time without any official sanction. But the real fact is that several of the smaller Indian joint-stock banking companies are working under the well-known managing director system and the managing director initiates the policy, carries it out and is mainly responsible for the final results. The other directors are mere figureheads easily dominated by this personality and though it must be recognised and acknowledged that these managing directors do not possess criminal intentions, yet their descent to Avernus is made possible by the absence of strict laws and actually facilitated by the co-directors who do not realise their own responsibilities.¹ It is

¹ See the recent judgment delivered in the Oudh Bank Case, 5th October, 1925, by the Judicial Commissioner Mr. Syed Wazir Hasan. The three directors who were

a mistake to think that the duties of bank directors end by merely safeguarding the interests of the shareholders. They are trustees for the depositors also and must pay attention to public interests and should not hesitate to reduce dividends when such a course of action is deemed essential in the interests of the depositors.

Even in England the long series of defalcations of clever and astute financiers during recent years—Jabez Balfour, Whitacker Wright, Hooley Farrow, Bottomley and Bevan—is drawing the attention of the public to the defects of the company law and public opinion¹ seems to incline to the view that the English Company Law relating to the duties of their auditors, the details of information to be published in their balance-sheets and the form in which the company prospectuses should be published must be carefully defined and strengthened.

Some sort of protection must be given to bank depositors for much reliance cannot be placed in the reserve liability attached to the bank share. It is essentially an English practice which has been copied here, but the question of collecting the unpaid portion of the bank share in times of necessity is no easy task. India is a vast continent of great distances and the joint family means joint rights of property and the civil judicial procedure is proverbially slow. All these tend to place great difficulties in the matter of realising the unpaid portion of the bank share.

Legislation may defeat its own object or may place troublesome shackles barring the path of the intelligent banker well-versed in the soundest traditions of safety and gifted with a long-sighted view of the real requirements of the nation. But unfortunately for India her roll of distinguished bankers is very limited. Except the late George Dickson who originated the amalgamation idea of the three

responsible for misfeasance and breach of trust were ordered to pay the liquidator the sum of advances made without security.

¹ Quite recently the Mandeville brothers floated bogus companies and defrauded the credulous public to the amount of nearly £500,000. These financiers of the City of London were found guilty and sentenced to six years' penal servitude. The policy of the *Caveat emptor* in the matter of company flotations is sure to be discarded in Great Britain and the Company Law Amendment Committee's recommendations are likely to be carried into effect early. The policy of issuing 'abridged prospectuses' is universally condemned and would be discarded soon. The law with reference to publicity of accounts and responsibility of auditors would be stiffened.

Presidency Banks and the late A. M. Lindsay who foreshadowed the application of the Gold Exchange Standard system to India and who had the adroitness to prophesy that "his scheme will be accepted by the Government in spite of themselves," the rest of the bankers had only chequered ideas and half enlightened notions on the banking needs and requirements of our people. Banking business should no longer be considered solely as a profit-making endeavour and the interests of the shareholders should not always predominate. Banks are endowed with the dignified prerogative of creating credit. Not only should they make a sound and proper use of credit but they should prevent as far as it lies within their hands any unfair use or abuse of credit. This prerogative should be exercised for the real benefit of the community leading to a full and wise economy of precious metals, extending production, enlarging manufactures and increasing trade and commerce. National interest and national benefit should be the actuating motives of the Indian banker.

When again there is no enlightened public opinion to chastise the shortcomings of the bankers or to effectively demand rapid development of sound banking facilities it is not wise to expect that everything would go on without a hitch. Advocacy of banking legislation rests not on the view that it is a panacea or substitute for prudent banking but on the sole belief that it affords the best basis for a sound banking and business economy and the surest safeguard for the stability of the currency.

The Government of India should realise that the real power of the banks is being blindly exerted in the direction of profits to the shareholders alone and that several of the smaller banks which are more numerous than the larger banks are not being controlled calmly by perfect knowledge. This is no insinuation against the present bank managers that they have expanded the quantity of bank credit out of all proportion to the general economic expansion of our country or that they have built up a huge credit structure on a small basis of cash reserve as is the case with the English banks. The sole contention is that the small banks are too anxious to attract business and they set at naught wise and prudential principles that should govern the supply of credit. For instance the supply of credit for buying fixed capital is discountenanced by all banking experts and financiers but some of the Punjab banks which failed in the crisis

of 1913 to 1915 lent too much money to the cotton-ginning factories, out of all proportion to the cotton-producing capacities of the province.

Some of the present banks are evidently anxious to bring about a rapid industrialisation of their provinces, thinking that banking credit alone would enable the raw materials to be successfully manufactured into industrial products. Although credit facilities are sorely needed it must by no means be concluded that banks should dispense with the following points in the matter of granting credit. The business capacity of the applicant, the prospects of an early repayment of the loan, the general political situation, the reliability and commercial standing of the applicant and lastly the bank's own financial position should be always kept in mind by the bankers. Loans to small traders who are unable to produce good bankable securities and to small manufacturers who cannot show orders from good firms or invoices of goods already sold and ready for despatch are unsound and these rules never loom large in the minds of the small joint-stock bankers of this country and as a matter of fact several of these combine trading with banking business. Some of the Bombay banks finance speculators on the Stock Exchange or cotton, grain or bullion market on a very extensive sale. The smaller joint-stock banks are nothing but mere money-lending institutions bearing the honourable caption of "banks."

Although credit has not been put to any misuse in this country yet the proper husbanding of our credit material and the correct use of it is not to be seen in the case of the small banks. It must be understood by these banks that credit is one of the factors indispensable for increasing the wealth of a country and so long as credit increases the supply of commodities it tends to cancel the tendency for prices to rise. Hence if the loans and discounts of our banks actually augment the stream of commodities flowing into the hands of the community its actual wealth increases and a right use of the credit is made by the bank. But if our banks succeed in placing credit in the hands of those who fail to increase production they would be rendering a fatal disservice to the community firstly by the mis-direction of credit, secondly by raising the purchasing power of money in the hands of the people which tends to raise prices and this tendency towards increasing prices is not counteracted by increased supply of

commodities and lastly they are endangering their own financial standing by entrusting their resources to the incapable and undeserving produces to whom no quarter should be extended.

Suggestions for Banking Legislation.

It is indeed a matter of deep concern and profound regret that the Government of India have not turned their serious attention to this subject. They have all along been upholding¹ the vested interests of the Presidency Banks and the Exchange Banks which display no grain of sympathy with the newly-started rivals and the Government of India sat calmly with folded hands while even some of the sound Indian joint-stock banks were forced to suspend their business during the crisis of 1913-15. Perhaps the moral responsibility to help the poor public did not weigh sufficiently strongly with them.

Every Western Economist of reputation repeats the hackneyed opinion that Indians are prone to the hoarding habit.² The Government of India relies on this opinion but yet takes no remedies to enable the people to divorce this habit. With the exception of the stipulation that the Imperial Bank of India should open a hundred branches within five years of its starting and the increase of capital they have insisted upon which certainly will help their own financial business, they have not taken any other worthy measures to effectively counteract the so-called "hoarding habit" if it really prevails among the Indian population. They have not expanded even up

¹ The upholding of the monopoly of the Exchange Banks in matter of foreign exchange business is considered a grievance by the shareholders of the Imperial Bank of India. The refusal of the Government of India to deposit their money in the Indian Joint Stock Banks as in the case of the Presidency Banks is cited by the late Mr. Chunilal Saraiya as an evidence of the partiality shown to the Presidency Banks. The Presidency Banks considered the deposit of Government balances as a compensatory measure for their being deprived of their note-issue. But if one remembers the small amount of their note-issue and the high Government deposits they have been enjoying for quite a long time the conclusion that forces itself on one's mind is that a sort of preferential treatment is meted out to these banks.

² Only the recent Sir H. B. Smiths' Committee has grasped the truth and it says that India's use of gold as a store of value is justifiable in the absence of saving facilities. It also points out how the use of gold in social ceremonies is sanctioned by tradition and religion.

to the present day the savings banks system in any way to suit the convenience of the public at large.

It is of no use to blame the illiterate people while effective measures are not being taken to wean away the people from this pernicious habit. Neither have they induced the people by allurements to deposit money in the Postal Savings Bank nor have they protected them when bogus banking companies were inducing them to deposit their money in their vaults. On the other hand the banks are finding it increasingly difficult to attract deposits from the people as the Government is attracting all available savings by paying 5 to 6 per cent. rate of interest for all its loans and treasury bills it raises in the money market. Sir Dorab Tata referred to this¹ fact and complained bitterly of the impossibility of the Industrial Banks ever hoping to pay such high rates to their depositors in the expectation that a still higher rate can be realised from the industrialists.

If the attitude of the Government of India towards banking business in normal times is hardly inspiring, their attitude in abnormal times is hardly worth mentioning. In Canada and the United States of America the federal governments undertake the duty of converting the notes of a failed bank and this government guarantee is a virtual protection against their depreciation. Their general understanding is that "the government is behind the banks." "In India however there is a vague responsibility, according to Mr. J. M. Keynes, lying on the shoulders of the Government of India to come to the rescue of the banking system in the event of a widespread failure."² When the clock of banking progress received a rude check in the crisis of 1913 to 1915 very little was done to alleviate the situation. In future at least the Government should undertake the task of resuscitating and reviving the business of sound banks when they

¹ Owing to the inadvisability of conducting industrial financing with money borrowed at a high rate the Tata Industrial Bank has transferred its industrial business for the present. What led them to this decision was that the rate of interest which the government are prepared to pay for loan and treasury bills coupled with their continued necessity for keeping in the market will militate against any industrial bank obtaining necessary funds for industrial business. Since the above was written the Tata Industrial Bank has been amalgamated with the Central Bank of India.

² See his Memorandum on the State Bank appended to the final report of the Chamberlain Commission.

meet with any calamity. In order to better perform this task the Government should introduce some amount of control by legislation, inspection or other means even during normal times. The Government of India should only remember the adage that 'it is never too late to mend.'¹ Its recent decision² to postpone legislation should be revoked and it would be highly expedient if it bears in mind the suggestions outlined below. "To expect the nation to work out its own banking salvation by means of its own experiments and its own experience" is unwise economic statesmanship.³

Bank.

The word "bank" should be restricted in its application only to those financial companies which undertake to meet all obligations on "demand" and subject themselves to be drawn upon by means of cheques. It should be denied to bogus and unsound companies with a large inflated nominal capital whose sole desire is to exploit the public under the patronym of the word 'bank.' It is indeed difficult to define the word 'bank' and banking legislation should not be extended to those indigenous bankers who do not burden themselves with others' money to any extent as joint-stock banking companies do.

Capital.

In the matter of the banking companies the authorised capital should never be allowed to be higher than 4 to 6 times the paid-up capital. It would not be unwise if the Government of India were to set up a minimum limit to the banking capital which should be declared necessary for a certain amount of population, taking into due consideration the character of their business and their demand for credit.³ If an adequate amount of capital is to be had from

¹ Letter of the Department of Commerce and Industries, 17th November, 1920. (Letter No. 8071.)

² Sir James (now Lord) Meston refused to consider the question of banking legislation on this pedantic plea.

³ The Fascists of Italy who are controlling their banking organisation thoroughly contemplate the granting of power to the Bank of Italy, the Central Bank of Issue, to

the beginning all temptation to tout for business would be removed. It would also be wise on the part of the Government of India to stipulate that of the subscribed capital half should be paid-up at the starting of the banking companies' actual operations and provision should be made that a substantial part of the balance should be paid within six months of the registration of the banking company. Much benefit would also accrue if permission is denied to the banking companies to parade the amount of their "authorised capital" in their balance sheets. Only the subscribed capital and the paid-up capital should be published and if any amount of reserve liability is attached to the bank share it should also be published. Otherwise the fact that it is a fully paid bank-share should be mentioned. No real benefit can be reaped by publishing the 'authorised capital' of the bank. The ignorant public, who do not very often possess correct notions as to the real difference that exists between the three items, are apt to be led astray by these figures. If permission is given to publish these various items all of them should be printed in the same attractive type.

Reserve Fund.

The Government of India should compel the banks to build up a decent reserve by setting aside a part, say $\frac{1}{10}$, of the annual net earnings of the banks till the Reserve Fund amounts to half of the paid-up capital and then only should the banks be permitted to distribute the whole of their earnings as dividends to the shareholders. The law should also aim at prohibiting the banks paying dividends when substantial reserves have not been piled or when bad debts have not been completely written off. It should also be the aim of the law to see that if the Reserve Fund is invested in securities only gilt-edged securities should be selected for this investment.

A concealment of the bad debts is usually wilfully and knowingly done at the time of the preparation of the bank balance sheet. This might not be done with a dishonest intention and due provision might be made out of the Reserve Fund for that full amount of suppressed

examine the situation before permitting any new Bank to be started in any locality. Over-capitalisation or under-capitalisation are thereby avoided,



bad debts. As this act however violates the form according to which the balance sheet of a bank is to be published it amounts to a legal offence.¹

Loans.

The law should permit the banks to lend money to their directors only on the strength of securities and not its own bank-shares and at such rates as are charged to the other customers of the bank. The law should make it compulsory that if the directors or industrial companies in which these directors are interested apply for loans, they should not be permitted to attend the Board of Directors' meeting lest their presence may induce the co-directors to vote for the loan. The banking company should be prohibited to grant money to its customers on its own bank shares and upon other bank shares if a large portion of them is unpaid. Loaning on real estate should be prohibited but the bank may be permitted to entertain real estate in the event of the depreciation of original security tendered as cover for the loan. It is a matter of sincere gratification to note that the Investigation Committee of the Bank of Mysore appointed to examine the advances made to the bank directors has recommended that a limit should be placed on the power of the bank up to which it can advance within the value of the securities pledged.

The law should restrict the amount of loanable money to individual borrowers to a limit of 25 per cent. of the capital of the bank and if more advances are needed they should be made on actual consignments taking care to hold the bills of exchange and their attendant documents as security or the actual deposit of recognised securities accompanied with a letter of hypothecation.

Investments.

The law should be wise enough to restrict the banks from having too large a holding of one kind of security loan though it be a Government security and the banks should be permitted to invest their money

¹ It is on this ground that Mr. S. N. Pochkhanawala and others of the Central Bank of India were sentenced to a day's simple imprisonment and a fine for making false statements in the balance-sheet. (See the proceedings of the Presidency Magistrate

in trustee securities, and as industrial securities are purely of a speculative character there should be an attempt to prohibit the commercial banks from holding too many of such industrial securities.

The rate of interest from these investments should not be lower than what is actually paid for money borrowed and as all such investments are unsound finance the banking companies should not be permitted to invest too freely in them.

Directors.

Many of the smaller banks award the directorship to influential people who are likely to bring business and lend to the bank a colour of respectability. Many of these do not possess the technical knowledge for the management of banking business. Generally they have neither the leisure nor the qualifications for handling efficiently the problems of banks.¹ This inefficiency must be put an end to as early as possible. Although we have come across the tendency in some countries to appoint only people possessing adequate banking knowledge as bank directors it is difficult to insist on such a step and subject these people to a compulsory examination before being appointed as directors. But much improvement can be secured by enacting it illegal to appoint directors who already hold half-dozen directorships in trading or other kinds of joint-stock companies. This tends to make the director consider his position as a pleasant semi-sinecure one and no effort is made to interfere in the management of the bank.² One of the salutary reforms approved by the recent Commission on Banking Reform in Japan was to prohibit bank directors or other officers from serving as directors of any other business concern.

of Bombay, Feb. 28, 1928.) Since these lines have been written this procedure has been allowed by the Government as a lawful expedient and it would no longer be considered a legal offence.

¹ See the evidence of the Directors, Messrs. Deaton and Abdulla of the Agricultural Bank of India in the criminal case against Shanker Lal, Managing Agent, before the Special Magistrate of Bangalore. The flotation and everything else regarding the Bank was left to Shanker Lal and the Directors were induced to join on the pretext that high financial support or backing has been secured.

² The second advantage would be the preventing of industrialists from securing control over the Bank. That such a thing would be disastrous can be easily guessed by the example of the Alliance Bank of Simla.

Even in England the general public would not permit the bank directors from undertaking the work of other companies as it would curtail their time and energy towards the business of the bank. In 1926, Mr. R. McKenna was very adversely criticised for having accepted a seat on the Board of Canadian Pacific Railways.¹ A bank directorship means enough responsibility and when it entails full demands on the time of the director it is sheer folly to accept seats on other boards of industrial concerns.

If the law makes it possible for the depositors to elect their own representatives possessing special qualifications in banking, finance and investment it would go a long way in securing the needed efficiency. If it is considered inconvenient to allow the depositors to interfere with the daily management of the concern a Supervisory Council wherein the depositors and other shareholders might be represented must be created by every bank.² There must be quarterly meetings of this Supervisory Council or Committee to cross-examine the work of management, to make the appointment of qualified men for the higher appointments in the bank and many of the grave abuses incidental to the present Boards of Directors of the smaller banks can be remedied by vigilant action on the part of the Supervisory Committee. The value of a good Supervisory Committee to the business of a bank would be very great.

Acceptance Business.

Now that it is the aim of the bank reformers to develop bank acceptance business it is essential to see that there is no danger arising out of this business. Accepting bills of exchange by the smaller banks would always be a danger. Hence banks not possessing 5 lakhs of rupees of paid-up capital should not be made to accept bills of exchange. Accepting banks which do not possess a decent amount of paid-up capital should not be made to accept bills of exchange. They should not only possess a decent amount of paid-up capital but the volume of acceptances outstanding at any time must be equal to their paid-up capital *plus* reserves. It must be

¹ See the Bankers' Magazine on Mr. McKenna's accepting the above seat. Sep., 1926, p. 178.

² Such a practice of appointing a Council of Supervision exists in the case of all public companies in Germany.

laid down clearly that the amount of acceptances for any individual, firm or company must also be limited. If banks accept bills under such salutary regulations it may be possible to find buyers for these bank acceptances. Slowly and steadily a bill market would arise and if re-discounting at the hands of the Central Bank of Issue is forthcoming the development of an open market for bills can be easily secured in this country.

Banking Business.

It has too often been noticed that our small banking companies combine trading and other functions along with legitimate banking operations which are bill discounting, loaning and attracting of deposits. The law should prevent such a combination and the Registrar of the Joint-Stock Companies should be empowered to delete from the Memorandum and Articles of the Banking Company all clauses that may be considered as running counter to the interests of the public or it should be restricted from performing functions as are not usually conducted by banking companies elsewhere. To prevent the Registrar from being the final arbiter in all such cases an appeal should be allowed to the judicial authorities in all matters of doubtful decision.

Criminal Punishment.

There is an urgent necessity for the tightening of the criminal law making the directors, the managers and the auditors of the banking company personally liable for deliberate fraud practised on the company or a wilful and a deliberately fraudulent maladministration of banking funds.¹ Those auditors who certify the different balance sheets negligently or knowingly in most cases that everything is correct should be taken to task and the auditors' section, 145 (2) of the Indian Companies Act, must be reformed and heavier penalties imposed in all these cases. On the other hand their power to call for more information and properly assess the value of the different assets should be strengthened.

¹ It is only in the recent Punjab Industrial Bank affairs that the ex-director Mangal Sen was given exemplary punishment for his falsification of accounts and criminal breach of trust of sums involving lakhs of rupees. The total period of imprisonment served out to him was about 18 years. Such a deterrent sentence would prove a valuable eye-opener to the directorial "crook" who is often responsible for bank failures.

Savings Bank Business.

It has become the common practice prevalent among the Indian Joint-Stock banking companies to attach a department for conducting savings bank business. In all such cases, the law should compel the banks to invest half of this sum secured in the savings bank business in securities approved by the Indian Trust Act and these should be earmarked for that purpose. The savings bank business, if properly developed, will help to create a banking habit in India.

Balance Sheet.

In accordance with Form 9, III, Schedule of the Indian Companies Act, every banking company incorporated under this Act has to publish details of its business operations. But this form is not at all a detailed one.

The particular items of the different banking operations should be amplified and set out in greater detail. A frequent publication of a balance sheet will secure the confidence of the depositors and the general public who may like to transact dealings with banking institutions. Such publicity would go a long way in restricting the scope of the bank and prevent it from undertaking injudicious transactions.

The intention of the Government of India to make it compulsory on the part of the banks to publish monthly statements of business amplifying the necessary particulars that are to be published is to be hailed as a welcome measure and their intention to secure the interests of the depositors is a noteworthy one. They have adopted the set form originally approved by the Cunliffe Committee. Even in present-day England this reform has not yet been carried out. Barring Lloyd's Bank other banks do not issue informing balance sheets and all Indian Joint-Stock Banks would be forced to publish their

monthly balance sheets as soon as the necessary alteration takes place in the existing law. This form is as follows:—

Liabilities.

1. Authorised capital (shares of rupees each)
2. Subscribed „
3. Paid-up „
4. Reserve Fund
5. Current Deposit and other accounts.
6. Loans against securities *as per contra*.
7. Acceptances on behalf of customers.
8. Endorsements, guarantees and other obligations.

Assets.

1. Cash in hand (Coins and Currency notes and balances with the Imperial Bank of India).
2. Balances with other banks.
3. Bullion in transit and hand.
4. Money at call and not more than seven days' notice.
5. Indian and British Government securities maturing within 12 months.
6. Inland bills.
7. Foreign bills.
8. Balances abroad.
9. Investments.
10. Loans and Advances.
11. Other Assets.
12. Bank premises.
13. Liabilities of customers for acceptances.
14. Liabilities of customers for endorsements, guarantees, etc.

There is no gainsaying of the fact that this balance sheet is infinitely better than the existing one that has to be published ¹ along with the annual summary which a banking company working under the Indian Companies Act of 1913 has to forward to the Registrar of the Joint-Stock Companies. However it would be better if these suggestions are also accepted and an improvement is made in the above form.

1. The authorised and subscribed capital need not be published at the head of the liabilities column. An asterisk should be placed opposite the "paid-up capital" item and as an explanation of this following asterisk these details should be given in a foot-note.

¹ The monthly monetary returns to be made by the Scheduled Banks to the Central Reserve Bank of the country would create confidence in the minds of the public as regards the character and nature of their business. If the Central Bank of Issue were to examine the assets of the Banks periodically before rediscounting the bank's bills of exchange it would lead towards raising the standard of banking business on the part of the banks.

2. The word 'loans' against securities refers to the "borrowings" of the bank and the word 'borrowings' should be substituted for loans.

3. The item "loans" and "advances" should be divided under suitable headings as given below. Such a rational division is insisted upon by the Baroda Government and if all banking companies have to subdivide their loans and advances as follows it would enable the public to ascertain the stability of the bank, for the art of banking wholly lies in successful loaning on realisable securities.

(a) Loans secured by the personal guarantee of two or more persons besides the actual indemnity of the borrower. Under this heading come the well-known cash credits of our banks.

(b) Loans or the consignment of bills as security.

(c) Loans resulting from an overdraft arrangement.

(d) Loans granted to directors and officers of the bank.

(e) Loans granted to Joint-stock companies on securities.

(f) Loans granted on Joint and Several promissory notes.

(g) Loans considered as doubtful accounts.

4. The nature of the different investments should be specified in detail as follows :—

(a) Securities of or guaranteed by the British and Indian Governments.

(b) Colonial and Foreign Government Securities.

(c) Other Indian Trust Securities.

(d) Shares and debentures of Indian Joint-stock Companies.

(e) Other investments.

Banking Control.

There is no use of bare laws being passed but an efficient machinery to secure their proper observance by the different banking institutions should be created by the Government.¹ The Government

¹ Although industrial legislation was enacted in this country still the steps to enforce this legislation are not adequate even at the present day. From the report of Industries in Bengal one can understand how meagre the inspecting force was with the result that

of India should have a separate department to inspect the banks or appoint officers of the Indian audit department to carry on an independent audit of the banking work, not merely to supplement the work of the auditors appointed by the shareholders but to make effective suggestions as regards the actual work that is done. The report of the surprise audit should be in duplicate and one of them should be sent to the Registrar of the Joint-stock Companies and the other should be sent to the Board of Directors.

The sole reason why reliance is placed on the Government audit is this. The present knowledge of the auditors is very meagre and the majority of them possess no extensive knowledge of the banking machinery. Several of them wilfully and knowingly permit the managers to indulge in unsound finance thus imperilling the financial stability of the institution. The Government audit will not be open to this grave defect and as the report is not thrown open to the public no damage to the credit of the bank can be inflicted by any suggestions the Government auditor can make. It is for the Board of Directors to loyally adopt all their suggestions and bring about a better and scientific management of the banking institution than before. Such a compulsory outside audit would go a long way in standardising business methods, enforcing conformity to statutory and conventional requirements and giving strength and public confidence to banking in this country. To the English bankers "unfettered with chains of restrictive legislation" any meddling of the state officials in the internal economy of the banking profession might appear as a violation of healthy freedom. As the Bullion Committee Report puts it "financial legislation is interference." *Prima facie* legislative interference is bad but the suggestions outlined here would not be practically objectionable. Compulsory legal regulations on the lines suggested in this chapter would not be either an impediment to efficiency

in 1923 only $\frac{1}{4}$ of the factories were inspected more than once and more than 1,000 factories were not visited once even in the course of the year. Except in Bombay adequate arrangements for proper inspection are not made. Indians are not generally admitted into this line and women inspectors of factories are very few. Not only are the factory laws not properly enforced but as there are very few prosecutions and very small fines on the offenders all those salutary precautions are not strictly enforced. Even in the case of the co-operative societies the audit work is not efficiently done as there is not one auditor for every hundred co-operative societies in Bengal.

or an excessive limitation tending to injure the freedom of the banker. Similar provision for legislation and efficient inspection of banking companies exists both in the Dominion of Canada and Denmark. Without Bank Inspectors free from and independent of practical interference or any other machinery to enforce the rigid observance of banking laws there is no wisdom in enacting mere regulations.¹

The author is not unaware of the defects of mere formal and mechanical Government inspection. The public would also be led to imagine that by mere State inspection the banks are conducting sound business. It is true that the responsibility of the Government would become apparent if their inspecting staff fail to detect weaknesses and it is their bounden duty to permit no banks to continue in this state of business if they have detected any flaws. Mere bank inspection does not however tantamount to Government guarantee of deposits. In view of the special circumstances of the country the need for considerable measure of Government control over the banks is essential and must be recognised. Bank inspection must give good assistance, wise counsel and provide tactful control. This reform practically imposes financial burden and more administrative duties but if a good deal of headway is to be made against popular apathy these have to be shouldered. Public confidence in banks can result only out of the Government's intimate relationship, scrutiny and control over the bank.

Cash Reserve.

It may appear a ludicrous inconsistency if no regulations are outlined with reference to the holding of the cash reserve of the banking companies specially after what has been written before under the heading "the rationale of banking legislation." The omission

¹ See also the report of the Commission of the American Financial Experts headed by Dr. E. W. Kemmerer, on the state of Banking in Poland—the necessity of inspecting the banks to ascertain their solvency and judge whether business is conducted according to regulations or not, is clearly brought out. A commissioner aided by an adequate staff of inspectors is to be in charge of this inspection work. The recent Banking Commission in Germany is contemplating measures to enforce greater liquidity of operations on the part of the Commercial Banks to make specific statement of liabilities and to insist on a prompt publication of balance sheets.

of any laws as regards the cash reserve is justifiable if the other banking operations are conducted according to the regulations outlined here. Such a wise transaction of the other banking operations will render unnecessary a large cash reserve and if the assets chosen are liquid and easily realisable with minimum of loss to the banker a smaller cash reserve will be found sufficient. Although a legal regulation of the cash reserve can be easily justified on principle yet it can be better regulated if the hands of the bankers are unfettered in this direction. If mutual help is forthcoming as the result of an *esprit de corps* prevalent among the bankers it will enable the bank to pull through an emergency except that of a concerted 'run' and in the event of such an unforeseen contingency no amount of cash reserve will likely prove sufficient.

Credit Wreckers.

No amount of legislation against credit wreckers would be of any avail if the bankers do not conduct conservative banking and keep their assets as far as possible in a liquid state.

Immigrant Banks.

The treatment accorded to the immigrant banks is a very fair one and the Government of India wisely refrained from raising a Chinese Wall and refusing access to foreign institutions. This has led to the investing of foreign capital in our country. The exchange banks express their unwillingness to subject themselves to any banking laws that may be passed by the Government and they are unwilling to publish any monthly balance sheet according to the proposed form.

In justice it must be admitted that they never transgress the established maxims of sound banking nor are they inadequately capitalised. Their capital is being employed here as well as in the country of their origin and it cannot be ascertained with any degree of accuracy nor is it safe to publish the ascertained amounts of capital they employ here and at home. So long as they keep adequate balances for their Indian deposits, that is, deposits attracted in India there is no reason why they should be subject to the statutory rules that may be enacted here. Although they might not be made subject



to this legislation still they can be forced to train Indian apprentices in the higher field of banking practice. The foreign banking corporations in Turkey are forced to employ Turks on a fifty per cent. proportion on their staff. Quite recently the Ionian bank was threatened with stoppage of business for failure to carry out this provision of law within a stipulated date. The latest piece of information¹ about Nationalist Turkey's attitude towards foreign banks can be judged by their refusing to permit the foreign banks to use the calculating machines, etc., to dispense with labour. The Turkish Government evidently were anxious to retain employment of men of their own nationality in the banks rather than permit them to employ machines and dispense with the labour of clerks.

Just as the private indigenous bankers are to be exempt from the application of these laws similarly these immigrant banks should be accorded quite a separate treatment from the Indian Joint-stock banks but favouritism should not extend further.²

Private bankers are exempt from legislation in every country. Even in the United States of America where there is stringent banking regulation there is not much interference with the business of the larger private bankers. Sec. 160, of the New York banking law contains these restrictions levied on the smaller private banks.

Banking Statistics.

The statistical information available in India is quite inadequate to enable the country to deal with the different problems of bank extension, safety and legislation. They are published at different times in different blue books generally at a too belated hour to be of any use to the serious student of banking problems. The statistics officer should be given statutory power to inaugurate a scheme of publicity on the lines outlined already. Any other items of information which the banks are willing to publish can also be published. The erroneous idea that a rich country like the United States of

¹ See the "Statesman," July 14, 1928.

² Formerly the Indian Exchange Banks in London used to get deposits from the Secretary of State for India out of the London cash balances at very cheap rates of interest.

America alone can afford to have great expenditure on statistics must be dispelled. A certain amount of overlapping, duplication and sheer waste may result in the endeavour to collect information. But publicity would have a decisive influence on the conservativeness of the banks. Banks would naturally hesitate to give any information which might encourage competition. But the nation as a whole cannot acquiesce in this decision. Banks control the economic destiny of the nation and banking laws should be so framed as to secure this wider end in view. The interests of the nation are closely bound up in the whole question of the reform of bank operations in the direction of greater publicity.

CHAPTER XVIII

RECENT MONETARY REFORM : 1927-1928.

Act. IV of 1927—Significance of the fragmentary reform—The new currency standard—The currency authority and deflation—Emergency currency—The sale of Treasury bills—Their meaning—Their utility—Repayment—When was this policy adopted in India—The object of the sale of T. bills—Supposed disadvantages—Justification of the sale of T. bills—Limit to the sale of T. bills.—Remittance programme—Purchase of sterling in India—Several alternative methods of remittance—When was it taken up—Reasons for this change—The main advantages of this scheme—Disadvantages—Conclusion with reference to remittance programme—The dangers of external borrowing—The policy of the Government of India—Recent sterling Loans—Conclusion as regards public borrowing—The defects of the existing regime—The silver situation—Suggestions to improve the situation—The other recommendations of the Hilton-Young Commission.

The enacting of the Ratio bill on the Statute Book as Act IV of 1927 and the Indian Legislative Assembly's refusing to consider the Gold Standard and the Reserve Bank Bill, led to fragmentary reform of the Indian monetary situation. As in the case of all attempts at fragmentary reform it has proved to be a blunder and instead of the drastic reforms outlined by the Hilton-Young Commission being carried out *in toto* the least important of the suggestions has been carried out and the more momentous ones allowed to "go hang." It has really ended in tinkering with the situation while real comprehensive reconstruction has been postponed *sine die*.

Significance of the Fragmentary Reform.

The inner details of the Hilton-Young Commission's proposed monetary reform have become thoroughly familiar to our people. The present situation brought about by stabilising the exchange at 1s. 6d. gold value of the Rupee has been described as the "hardening" of the gold exchange standard prevailing in the country.¹ As this runs

¹ See the Economist, London, 18th Feb., 1928.

counter to the popular aspirations of the people the real significance of the fragmentary reform has to be studied. Although the present writer is not convinced of the suitability of the scientific gold exchange standard to this country, yet as the I. L. Assembly gave the go-by to the Reserve Bank, working as the sole authority, managing credit as well as currency, several of the inherent defects of the currency system of the pre-Hilton-Young enquiry period remain and a sincere attempt should be made by the currency authority to carry out several of the suggestions outlined here in so far as they are practicable and thus remedy some of the more glaring defects and give an assurance that manipulation of the reserves would not be undertaken, that seasonal expansion would not be delayed as soon as money becomes stringent and the Bank Rate has attained 6 per cent., that the gold securities would not be frittered away and that there would be no confusion between the fiscal and monetary objectives in the sale of exchange. Some of the minor indications considered essential to create the confidence in the Government management of the currency system are briefly alluded to.

The New Currency Standard.

The present currency system is substantially the same as that outlined by the Hilton-Young Commission except that unfortunately it has to be operated by the Government as the currency authority and the methods to enforce the gold bullion standard are conspicuous by their absence. There are no well-defined means for selling and buying bullion at the stated prices and in the absence of huge stocks of gold bullion in the hands of the Government or a Central Bank it clearly cannot be undertaken on a large scale. The Indian Currency Act of 1927 established the ratio of 1s. 6d. by enacting that Government would purchase gold at a price of Rs. 21.3 as. 10 pies per tola of fine gold in the form of bars containing not less than 40 tolas and would sell gold or at the option of the Government sterling for immediate delivery in London at the same price after allowing for the normal cost of transport from Bombay to London. The Government's selling rate of sterling was fixed at 1s. $5\frac{9}{16}$ d. to discharge the above obligation.

The silver rupee though mainly intended to be the unit of account is still the sole standard. The future of the silver rupee is still practically illogical and has the dangerous quality of legal tender privilege attached to it. Its interconvertibility into gold or gold exchange is also legally secured.

Confident of the facts that India would have a favourable balance of trade and that the world would stand in need of India's raw material during the period of industrial regeneration and as India is repurchasing its own securities and converting external into internal debt the new exchange ratio of 1s. 6d. for the silver rupee was fixed. This plus valuation on the pre-war ratio of 1s. 4d. for the silver rupee was fixed almost in deliberate violation of the experience of an overwhelming majority of people who have never noticed the persistence of this ratio for such a long period as to be claimed as the "de-facto ratio."

The currency authority is of course saddled with the double obligation to buy and sell gold bullion when offered in a minimum quantity of 40 tolas gold at stated prices. It has to buy gold at Rs. 21 3as. 10 pies for tola and it would sell gold bullion at a certified price which includes the normal cost of transporting gold from Bombay to London or in lieu of this obligation it would sell sterling for immediate delivery in London at the same price. A rate of 1s. $5\frac{4}{8}$ d. was fixed as the Government's selling price of sterling to meet this obligation. Under the old system the Government had to freely offer rupees for sovereigns tendered to it. The excrescent currency, viz., the gold sovereign has been demonetised and in its place this new obligation of buying and selling gold or sterling has been inserted. Though in theory, this provision differentiates it from the gold exchange standard system which makes the gold exchange alone available for external purposes yet in actual practice of the present standard the free and unrestricted buying and selling of gold is not taking place on any appreciable scale. In the anxiety to economise the use of gold the currency authority might actually tend to make this new standard hardly different from the gold exchange standard system. The provisions to buy and sell gold can be rendered innocuous and if the gold bullion standard as operated by the Currency authority does not after all assume the conversion of local or internal

currency into gold without the intervention of external currency it must be considered a decided failure.

The Currency Authority and Deflation.

Coming to the course of actual currency operations during 1927-28, the currency authority is still under the opinion that deflation can be practised even during the busy season. The necessity for deflating the currency system is to be admitted only when world prices have fallen tremendously and the internal price-level has to be adjusted to the new level without unduly stifling the supply of currency to trade demand at home. As "immense inflation" was practised during and after the war period and as subsequent deflation was "partial and hesitating" it still continues the best traditions of deflationism. The advocates of 1s. 4d. rate attach undue importance to the influence of this contraction of currency over exchange, while, really speaking, if any contemporary improvement of the foreign trade balance of India and the economic situation of the world were not affected the rise in exchange can never be secured. The action of both these dynamic factors has been neglected while studying the exchange ratio.

There has undoubtedly been a slight fall in world prices in 1926-27 and in the first half of 1927. A reference to the monthly index number of the League of Nations would make this point clear. So far as the United States of America is concerned the rise in the index number from 145 to 148 took place in September, 1927. Deflation in India is considered to have been moderate and in keeping with the fall in prices elsewhere. Instances of deflation can be quoted and on February 22, 1928, deflation to the extent of half a million was practised. Other instances of such deflationary attempts in 1927 can also be quoted.

What is required is a definite statement of the views of the Government as regards the time and circumstances under which deflation would be practised. The Government of India have a shrewd suspicion that the Indian money market is specially intolerant of deflation. Before any such charge can be levelled, the normal or average demand for currency must be clearly stated. If

it had been 20 crores per annum in the pre-war days what should it be at the present stage ? What allowance should be made for the growth of trade and population? While this positive information is not placed in the hands of the public some negative proofs of the redundancy of currency are given in justification of the deflationary attempts. The slackening of the grip of seasonal stringency in recent years, the return of rupees from circulation during the slack season, the small absorption of rupees in the busy season, the heavy cash balances of the Imperial Bank in the slack season and the release of currency before the actual purchase of sterling, point out unmistakably that no such heavy expansion of seasonal currency as in the pre-war years need be carried out. Although these are some indications of real value as regards the supply of currency still the practice of deflation without reference either to the home demand and supply of currency or the world level of prices would be arbitrary. Though it cannot be suggested that deflation is of a drastic character yet the impression is created that an unfair use of its power is being made by the currency authority in this direction. It has been stated plainly that were the Government to continue to act as the currency authority it would work better for purposes of contraction and any automatic expansion of currency, even at stipulated rates, so as to assure the businessmen of the safety of currency supply, can be delayed by it.

Emergency Currency.

So far as the supplying of seasonal emergency currency is considered the Government of India failed to provide the money market with the additional loan that could be secured, by the Imperial Bank, when the bank rate rose to 6% in February, 1927. This delaying of the seasonal expansion arbitrarily without paying heed to the hitherto enacted regulations shows that the Government of India have no faith in providing seasonal requirements or its anxiety to let no factor disturb the rate of exchange might have overruled all other considerations in this matter. That the Rupee ratio overruled all other considerations in this matter and that interests of trade and business are secondary to this prime consideration are very often



the conclusions that are drawn by this unjustifiable delay in supplying emergency currency and forcing the bank rate to rise to 7% before the emergency currency is released. Of course the psychological assurance that emergency currency would be available has its own influence in raising the bank rate is not denied. Again the impropriety of curing the high rates of interest for short-term periods by seasonal expansion of currency is undoubtedly recognised by the writer. Prof. E. Cannan has clearly demonstrated that the demand even for money would be affected by the mere assurance that emergency currency would be supplied. There is undeniably a certain amount of elasticity of demand for money and as it cannot be definitely stated how the rates of interest would be affected by the incoming advent of additional funds the forecasting of seasonal supplies at different levels of bank rate would be futile. But all my academic experience forces me to condemn the increasing of the stringency of money and subjecting trade to high rates which are preventable by timely action. It has already been shown that the Central Bank of Issue can by an increase of its note-issue and deposits satisfy the seasonal demands of emergency currency.

The Treasury Bills.

A new feature inaugurated by the currency authority in 1927-1928 was the policy with reference to the sale of Treasury Bills. The treasury bill system is of English origin.¹ It is purely meant to obviate the direct dependence on the Central Bank for advances to the Government. Denmark also recently adopted the system.²

¹ In the pre-war days the Bank of England floated Treasury bills when the receipts of taxation were insufficient to cover government expenditure. They were sold at convenient intervals to purchasers by tender. On April 14, 1915, the Bank of England issued several classes of Treasury bills with maturity up to 12 months after the date of issue. It was given up on 3rd February, 1917, and continued again from March, 1917 to June 1st, 1917. Treasury bills were again issued in 1919 and the English Joint-Stock Banks generally hold the Treasury bills in their portfolio. When the floating debt represented by the Treasury bills was funded the Banks took a part of this funded loan in lieu of the Treasury bills.

² See D. T. Jack, "The Restoration of European Currencies," p. 75 (foot-note).

Their Meaning.

The classification of the indebtedness of the Government of India into funded and unfunded,¹ external and internal and productive and unproductive has become well understood by this time. Ways and Means treasury bills fall under the category of floating or unfunded debt and are meant to be repaid during the course of twelve months. Treasury bills, as one critic aptly describes them, are "the last refuge of the drowning minister to keep up his head." Though this description is an exaggeration, it does not however fail to point out the fact that the Finance Minister lacking ready resources anticipates future revenue and floats these evidences of short-term indebtedness. This is the real origin of the Ways and Means treasury bills. But Treasury bills may be a legacy of war. It may be the policy of the Government to keep a portion of the permanent public debt in the form of T. bills.

Their Utility.

Like the commercial bills the treasury bills afford scope for the banker to employ his funds remuneratively and safely at the same time. Treasury bills can be rediscounted at the hands of the Central Bank during times of emergency. The ordinary banks and the finance houses consider these treasury bills as a safety-valve for if greater funds are needed for commercial finance they can reduce the advances to the Government in this respect and grant more funds to commerce. In the slack season when commercial demand for banking accommodation falls off the holding of the treasury bills can be increased for they will always be afloat on the money market. They can thus act as an invaluable aid to banks.

Secondly, it enables the Government to control the money market by this new and regular feature, and inflation or deflation can be pursued through this recognised channel. If it wants to inflate this

¹ The other constituents of the unfunded debt are the P. O. Cash Certificates, Postal Savings Bank deposits and other miscellaneous obligations such as the Provident Funds, etc.



floating debt would increase, and as it is disbursed by the Government the bank would get back the funds through the customer's balances and so this vicious circle of inflation can go on unchecked to a certain limit. Inflation used as a method of war finance was only an extended use of this well-known mechanism. If deflation has to be pursued the amount of bills running would diminish. By offering smaller amounts than are running off the Government can diminish the total number of bills in the market.

Thirdly, this process helps in creating a discount market. In the absence of an open market where trade bills cannot be discounted, the gap can be filled up by substituting treasury bills to a great extent. The liquidity of the resources is the prime criterion of the bank in holding any instrument in its portfolio. The unquestioned standing of the treasury bill and the possibility of readily converting it into legal tender money at the hands of the Central Bank makes it an ideal instrument for the banker and private financial houses who desire to convert their temporary cash into a desirable and liquid investment.

Lastly, the rate at which the treasury bills are discounted by the banks can be used as a long-distance signal for the raising of the bank rate. A great disparity between the two rates means that the bank rate is not effective, and the holding of bills is no longer remunerative. Foreign bill-holders may remove their resources from this field of lesser utility to a field of more promising return. This would mean the outflow of gold from the country to check which the Central Bank will ultimately intervene and this is done by raising the bank rate. Hence it can be described as the long-distance signal for the Central Bank's rate. These are the theoretical advantages that can be reaped by pursuing a scientific policy with reference to the sale of the Ways and Means treasury bills in the money market. It must be recognised that the United Kingdom has been the first country to point out the working of this intricate mechanism in the complex sphere of the money market.¹

¹ See Walter Leaf, "Banking," pp. 205-208. For a historical treatment of the use of the Treasury bills in the London Money Market, see W. F. Spalding, "Dictionary of World's Currencies and Foreign Exchanges," pp. 188 and 189.

Repayment.

The Ways and Means treasury bills are always to be repaid on maturity. Though certain impecunious Governments have sometimes converted them into permanent debt instead of repaying them, the best policy is to float a fresh batch of T. bills and repay them on maturity. Constant renewal of floating debt has a disastrous effect on the economic life of the country. In days of straitened resources this hand-to-mouth policy may have some justification.

When was this Policy taken up in India ?

It was first adopted by the Government of India during the period of the recent war.¹ They commenced the systematic sale of the treasury bills in 1918 to enable them to finance the requirements of the Imperial Government of the United Kingdom. Though there was no systematic adherence to this practice it was reintroduced in August, 1927, as a permanent feature of the financial policy of the Government of India. 'Three months' and six months' treasury bills, the lowest denomination of which is Rs. 5,000, are issued at a discount which sometimes comes up to a high rate. The practice has been continued since then and taking up the recent announcement on March 27, 1928 regarding treasury bills we find that "tender for six months' bills at Rs. 97 as. 9 and above aggregating Rs. 92,50,000 were received and

¹ The Government had to meet a very large amount of expenditure by issuing short-term debt. It continued outstanding till 1919 and when this increased figure had to be paid new Treasury bills were floated at a higher rate. With deficit balances and a large amount of short-term debt floating which at one time amounted to 50 crores of Rupees, the Government of India was forced to float loans in London and in India to pay their way and pay off some portion of the floating debt. By April, 1924, the Government succeeded in paying off the large portion of the floating debt which consisted solely of Treasury bills and Ways and Means advances. Treasury bills held in the P. C. Reserve were paid off and P. C. Notes cancelled to that extent. Good monsoons also helped the Government to succeed in raising the rate, i.e., the exchange value of the rupee. From August, 1923, the Government policy was to supply additional currency to the extent of seasonal requirements (see Sir Basil Blackett's Evidence before the Hilton-Young Commission, Vol. IV, p. 14, and the following).

accepted in full. Tenders for three bills at Rs. 98 as. 10 aggregating Rs. 12,25,000 were also received and accepted. The average rate of accepted tenders for six months is Rs. 97 as. 9 and ps. 4. From 21st to 26th March Intermediates were sold of which Rs. 6,25,000 were for six months and Rs. 3,75,000 were for three months. Intermediate bills will be issued from March 28 to April 2, at the following rate—Rs. 97 as. 10 and ps. 3 for six months' bills and Rs. 98 as. 10 and ps. 3 for three months' bills. Tenders for one crore of six months' bills and Rs. 75,00,000 of three months' bills will be received on Tuesday, April 3. Successful tenderers should make the payment of the amount accepted on Thursday April 5th. The average of interest of accepted tenders for three and six months' bills is again unaltered at $5\frac{1}{2}$ and 5 per cent." This rate would always depend on the money market rate for short-term loans when the tender is being made.

The Object of the Sale.

The first object of the present-day sale of the Indian Treasury bills is to regulate the Government balances evenly in India all the year round. This necessitates also lower balances.¹ The indirect advantages that are claimed are very many. It would tend to stabilise the value of the Government securities by preventing speculation in their value in the slack season with the help of bank money and the banks would be too eager and willing to lend money for the occasion. During the slack season "money becomes a drug in the market" and if it is lent to the speculators the Government securities would be subject to their influence. The banks themselves are great holders of Government securities and the stabilisation of their value is a great advantage to them.

Another indirect advantage would be the stabilisation of exchange that can be secured out of a judicious sale of these Treasury bills which can absorb the surplus funds in the money market. These funds would be deposited in the hands of the Imperial Bank and would be available to the market through this institution. Even if

¹ See Mr. H. Denning's Oral Evidence before the Hilton-Young Commission, Vol. IV, p. 74.

stringency in the money market were to result there would be release of funds through the purchase of sterling.

Secondly, a more stable bank rate all round the year would be realised if the bank balances are equalised during all seasons, viz., the busy as well as the slack seasons. It would undoubtedly help the Imperial Bank to obtain higher profits than before but this is purely an advantage to a particular institution.

Thirdly, it would reduce the necessity on the part of the Government to maintain huge cash balances for carrying on their daily round of duties. Now that two other valuable sources of finance exist, namely, the floating of treasury bills and the ways and means advances from the Imperial Bank of India, the third and antiquated one of keeping huge cash balances can be dispensed with. The reduction of heavy cash balances has been the objective of all monetary reformers of our country.

Finally, the great national advantage which the smooth functioning of the Treasury bill system would indicate is the help which it would furnish in fixing the bank rate of the Central Bank. If the rate for the Treasury bills is very low it is clear that the bank rate is not effective and the hidden hand of the Central Bank would soon have to be employed if gold leaves the country and exchange becomes unfavourable. Now that the Central Bank is not existing it clearly follows that this can be considered as a possible future advantage. At the present stage it may contribute something towards the perfection of the discount market and if the Imperial Bank rediscounts these Treasury bills for some period of their time before maturity some sort of preliminary education can thus be imparted to the bankers who can rediscount commercial as well as Treasury bills at the hands of the Central Bank.

Supposed Disadvantages.

But unfortunately the Banks which are the chief sufferers in this matter have already set up a protest and have determined to pursue a *non-possumus* attitude in this matter. Since Sir P. Sethna uttered a feeble protest against the sale of these Treasury bills the dissentient critics are becoming more loud in protest. Some have adopted a

blustering tone and in addition to non-co-operating in this matter the supposed disadvantages are descanted upon. Some of the prophesied evils are the crippling of the gilt-edged market and the eradicating of the Indian Joint-Stock Banks altogether from the money market. Lastly their unsuitability to this country where the Banks are struggling hard to attract deposits is commented upon. It is pointed out in a tone of derision that the Government are forced to pay "fantastic rates" of interest for their short-term indebtedness in spite of the much vaunted improvement in the credit standing of the Government. It is stated "that the credit of the Government is far lower than that of the credit of the banking institutions of the country."

Justification of the Sale of Treasury Bills.

It behoves us to examine these statements before any opinion can be expressed on the desirability of their sale. The first reason why treasury Bills are sold is to secure money for short periods when there is a big gap between revenue and expenditure.¹ If the ways and means advances from the Central Bank can secure the needed money, there would be no resort to the ways and means Treasury bills, for money locked up here would lessen the available funds for commerce and trade. Hence the bounden duty of the Government is to see that it does not encroach on the available commercial funds of the money market. If the balances of the Central Bank are depleted the method of borrowing in the market is resorted to. But so far as the Central Bank is concerned there is always provision to enable it to continue its business in spite of reduced cash reserves below the statutory limit. The raising of the rate protects the cash situation and increases the cash position of the Bank. Again when speculation is being conducted with the help of funds in the money market the Central Bank always raises the rate and protects the situation. If it fails to achieve this by raising the bank rate the surplus funds are withdrawn by borrowing on the Government securities. Thus it is always a recognised policy on the part of the

¹ The Land Revenue of the Government generally flows in during January and if heavy commitments are to be met in the months of September and October when cash balances are insufficient resort to this method is justifiable on the part of the Government.

centralised banking system to protect the interests of the people from the harm resulting out of unbridled speculation aided more or less by an easy monetary situation. If the Government of India is attempting to do this in the absence of a Central Bank there is no reason to feel aggrieved at the situation.

If the other advantages can also be realised the sale of the ways and means Treasury bills would have to be welcomed. If it contributes anything towards the perfection of the discount market and rediscounting becomes an acknowledged fact, this measure must be hailed as a welcome one. Of course the Government is not unaware of the difficulties of this policy. These would have to be discontinued as soon as a big loan programme such as that of the 1928-29 financial year would be launched and permission should be given to the holders of Treasury bills to subscribe to the loan. If more satisfactory conditions are meted out to the subscribers than in the 1927 Rupee-loan, there is no reason why such loans should fail.¹

In the *interim* period when banks feel the shortage of deposits they would have to pursue other measures for increasing the volume of deposits and they cannot force the Government to desist from controlling the market by means of this new method. The most successful methods of increasing bank deposits have already been stated in an earlier chapter.² If the sole grievance of the banks is that the Government is absorbing all available funds which would have been deposited in their hands the banks would have to increase their vigilance in the matter of securing deposits and they can also insist on rediscounting facilities being extended to them by the Imperial Bank. The Government, the Imperial Bank and the Indian Joint-Stock Banks can co-operate with each other and thus smooth down the peaks and troughs of credit occasioned by seasonal demands for money and the Government's financial policy.

It is recognised that in the slack season the Indian Joint-Stock Banks are too willing to lend funds on jute shares at a nominal rate.

¹ Since these lines were written the 1928-29 Rupee loan was floated and in spite of its being the biggest internal loan floated by the Government it proved a distinct success. The 1929-30 Rupee loan however has proved a failure. A Loan Council has to be inaugurated in order to regulate external borrowing in the International investment market. Greater opportunities to Indian investors is another essential improvement that is sadly neglected at present.

² See the earlier chapter entitled "Banking Resources."



Touting for business would be unnecessary and unused balances would not act as a drag on the bankers and speculation in the value of Government shares in the slack season need not be resorted to for obtaining decent profits. The Treasury bills would render these somewhat questionable uses unnecessary. They would furnish an element of strength, liquidity and profit to the bankers and other private financial houses. After the perfection of the discount market and the familiarising the banks of the rediscounting feature the employment of the Treasury bills should be confined to their legitimate function, namely, the securing of short-term money to tide over temporary deficiency and enable the Government also to give proper place to these Treasury bills in the public debt programme they follow.¹

Limit.

In other countries there is a limit set to the Treasury bills or short term obligations which the State can issue. In an undeveloped money market as ours the financial aid which the Government can secure from it should be limited. Otherwise there would be serious consequences to the credit position in the country. The charters of some Central Banks contain specific restrictions on the volume of Treasury bills that can be discounted for their respective Governments. A similar provision should be enacted in the charter of the Central Bank of our country. It should also be the accepted policy of the Government to secure this accommodation only at a rate which is consonant with the rate which Banks pay for deposits of a like period. As Hilton-Young says,² "the Treasury, while borrowing money for short terms at the lowest possible rate, should learn from its mercantile rivals in the loans market. It should compete for loans with commercial borrowers on an equal footing making use of all the refinements and economies which they have invented to facilitate their borrowings and in particular of the bill."

¹ The Budget should always make provision for the outstanding Treasury bills in the hands of the public at the end of the financial year and in no case should this figure be exceeded.

² See "System of National Finance," p. 241.

Remittance Programme.

The remittance operations, though recognised as properly belonging to banks, are still in the hands of the currency authority. The Government being the currency authority, can secure any pet opinion of its own through the influence of its remittance operations on the money market. If the monetary ideal of the currency authority is to economise the use of gold the free flow of gold into the country can be checked by purchasing sterling beyond the actual requirements of the Government. It should not however be confused with the currency ideal that has to be worked out in the country. More gold resources are essential for working the gold bullion standard in spite of any precautions that may be taken to protect it during the formative or the testing periods of its early years of existence. When America was parting with its stock of gold and co-operating with all countries who were coming round to the gold standard, the securing of gold as done in March, 1927, so far as the gold standard reserve was considered, should be carried further and, as the real gold metallic backing against notes in the P. C. R. is not sufficiently high, no opportunity to strengthen the gold stock should be lost.

The inauguration of the tender system in the purchase of sterling is another important factor or innovation brought about during the course of the financial year, 1927-28.

Purchases of Sterling in India.

The new system of remittance operations perfected by the Government of India during the course of the last half-a-dozen years is not thoroughly understood by the public. It is not only essential that its advantages and disadvantages should be understood but the far-reaching consequences underlying this method must be realised by all students of Indian financial problems.

The Object of Remittance.

The Government of India is a subordinate body subject to the sovereignty of the British Parliament. While it realises its revenue

in silver in India it has to meet certain obligations to the extent of roughly £35 mil. annually in London. This necessarily forces the Government of India to enter the exchange market for converting its rupee resources into sterling resources at as advantageous a rate as is possible for it to secure.

Several Alternative Methods.

Although theoretically speaking this can be done by several methods the most suitable and advantageous ones have to be resorted to in preference to others. Firstly, the sale of bills in the London Money Market on the Indian Treasury against the receipt of sterling in London can be done to suit the Secretary of State's requirements. This was the old time-honoured but recently discarded system of the sale of Council Bills in London.¹ Secondly, there is the purchase of sterling from *banks and private financial houses* willing to sell their sterling resources in London for rupees offered to them in India. This is the present method which has displaced the above one. Thirdly, there is the buying of gold bullion and exporting it from this country to London. The exporting of silver cannot be resorted to as it would be sending silver from the better market to a less advantageous one. The Government would be the loser by this method. Even in the case of gold shipment the loss of interest, freight and insurance charges would amount to much. Fourthly, the Government can buy sterling bills drawn on London from reliable *mercantile houses* and send them to the Secretary of State for collection. This method was actually employed for a while in 1877 but was afterwards given up. Fifthly advances can be made to merchants in India for purchase of goods consigned to the United Kingdom and repayable in England to the Secretary of State to whom the goods are hypothecated. The bills of lading of cargoes can be taken as security and thus remittance can be affected by this method. But inasmuch as their credit would not

¹ For a history of the Council Bill sales, see Mr. H. Waterfield's Memorandum—Appendix to the Fowler Committee's Report, p. 24; also Mr. Newmarch's Memorandum on the same subject, Appendices, Vol. I, No. 8, p. 20. See also Mr. Kisch's Memorandum on Remittances which consists of the 1915 rules with reference to this sale of Council Bills to the Hilton-Young Commission, Vol. II, pp. 484-89.

be of a high standing this method cannot be safely resorted to. It was actually employed to a limited extent by the East India Company and given up as "introducing a vicious system of credit and interfering with the ordinary course of trade." Lastly the Secretary of State can purchase the proceeds of loans floated by the quasi-public bodies in London and release its equivalent in Rupees in India. This method however is not always available but it is free from all defects.

Of these different methods each with its own limitations method two is the present accepted method of making remittances to London. The Government enters the money market and invites tenders on Wednesday at Bombay, Calcutta, Karachi and Madras. Purchases in the market can be made for the purpose of Intermediates on days when tenders are not received. Since these lines have been written the Government has inaugurated the policy of secret purchase in the slack season and invites tender in the busy season alone.

When was it taken up?

In the year 1923 the sale of Intermediate Councils was given up and sterling was purchased through the Imperial Bank from the Exchange Bankers and other recognised financial firms as a supplementary measure to the weekly sale of council drafts. The Imperial Bank was given the minimum buying limit by the Controller of Currency both of rate and of quantity but it was also altered during the course of the same day. Although large purchases were made under this method the question of inviting tenders to secure the best rates was not taken up at any time. Neither the extent of purchases nor the rate at which the purchases were made, were published by the Government of India and these were freely left to the discretion of the Government of India.

The old system of the sale of Council bills was not given up even in the official year 1924-25. Weekly sale of Council Bills was resumed only when there was a steady demand for rupees. But during the official year 1924-25 the sale of Councils did not amount to much. Even during this period much publicity was not thrown on these operations and it was only at the end of the month that the public could know the amount of purchases made by the Government in the

money market. The Bombay Chamber of Commerce protested against this "lack of knowledge regarding purchase of sterling and suggested that the weekly return of purchases should be published."

During the course of the official year 1925-26 no sale of Councils took place and it has been completely superseded by the method of purchase of sterling. The following table with reference to remittances makes this point clear:—

Official Year.	Sale of Councils in London.	Purchase of Sterling in India.	Purchases by Secre- tary of State of loan proceeds of public bodies raised in London.
	£	£	£
1922-23	2,570,026	70,000	2,126,210
1923-24	8,738,705	13,100,000	1,302,950
1924-25	7,579,162	33,191,000	700,000
1925-26 (9 months)	Nil	37,566,500	Nil

The respective advantages of competitive tender and private purchase of sterling through the Imperial Bank were discussed before the Hilton-Young Commission but the advantages or disadvantages of this procedure as against the old one of sale of Councils were not paid heed to. The Commission recommended the purchase of sterling in India by competitive public tender and the publication of weekly return of remittances. This is now followed in actual practice ¹ and would doubtless be changed as soon as the Central Bank is created for this country. The remittance business of the Government would be done through the Central Bank in much the same way as it would conduct the other banking business of the Government.

Reasons for this Change.

Though Mr. Charles Nicoll and Montagu Norman, the Governor of the Bank of England, opine that "a sentimental influence brought

¹ From April, 1927, the Government of India have been making weekly purchases of its sterling requirements by tender. Provision for Intermediate remittances is also made and the rate fixed by the Controller of Currency for the Intermediate T.T.'s is known as the "tap rate." If the rate is not liked by the sellers of T.T. the tap rate would be practically inoperative and whether any purchases according to the tap rate will be made can be foreseen by the number of applications made on tender days. The larger volume on the tender day indicates the possibilities of intermediate purchases.

about tendering in India instead of London" there were weighty reasons for pursuing this change. It was to take advantage of a "firm or rising exchange," that this new method of sending remittance from this country has been devised. It was also meant to check rapid appreciation of the rupee or any "undesirable up-rush of exchange" that sterling exchange was bought on an abundant scale. In October 1924 it was decided to prevent exchange from rising above 1 s. 6 d. by the free offering of rupees according to this method. This method was devised by Sir Basil Blackett and the Government of India had to adopt it as an advisable one in the interests of India and as an improvement on the existing method of sale of Council Bills.

The Main Advantages of the Scheme.

In days of fluctuating exchange it enables the Government of India to control the exchange market and with the full benefit of knowledge of local circumstances influencing the course of exchange, the Finance Member can do something to impart tolerable stability to the fluctuating exchange and thus confer a boon on trade and the country.

Exchange can roughly be pegged at the selected rate at which rupees can be released and thus the object of stabilising exchange at a particular rate can be easily obtained by purchasing sterling for unlimited amounts at the upper gold point of the selected rate. In the days of firm or rising exchange it can be employed to arrest the further rise altogether. Just as the unlimited sale of Councils at 1 s. 4½ d. prevented the free flow of gold into the country, the release of rupees at ½ d. lower rate than the upper gold point of the rupee would prevent the free flow of gold into the country. If the Government is prepared to buy sterling over and above the requirements of the Secretary of State the exchange can be artificially pegged at this upper gold point of the rupee rate selected. This they can do safely so long as they can increase the British or Indian Government securities in the Paper Currency Reserve and issue P.C. notes against the fiduciary cover which can amount to half of the total Reserve. The P.C. Amendment Act, February 1925, has conferred this privilege and so long as there is this safety-valve there

need be no apprehension that by this new method they would fail to peg exchange at the upper gold point of the rupee rate. The coinage of rupees is still left to the Government and so long as this capacity exists they can purchase sterling with the Rupees. *Ad Hoc* securities were recently created by the Government of India and Paper Currency inflated against them so that further rise in exchange even by $\frac{1}{32} d.$ would not be brought about. Leaving aside the undesirability of such expansion by questionable methods this prevents the free flow of gold; but the stability of exchange at the desired point which is the sole objective and absolute obligation of the Government would be obtained.

In days of weakening exchange this method would not be of any utility and the old policy of selling reverse councils at the lower gold point of the rupee has to be resorted to. So long as the Gold Standard Reserve is sufficient and kept at a highly liquid state for this purpose the selected rate can be made operative. Gold or gold exchange can be released without limit at the lower gold point of the rupee.

Under the old method of sale of Council Bills heavy cash balances could be kept by the policy of unlimited sale of council drafts over and above the Home Charges. Under this new method remittance can be made by the Government to meet the actual requirements and thus render unnecessary the piling up of huge cash balances in the Home Treasury. The sterling treasury bills can be floated by the Secretary of State in London if this remittance programme fails to provide him with adequate resources. It is no doubt expensive and this penalty should be incurred only as the last-go. There is thus total emancipation from the Secretary of State's control in the matter of remittance programme and some degree of monetary independence has been conferred on the Government of India. By unlimited sales of Council drafts over and above the requirements of the Home Charges on the specious plea of satisfying trade requirements he used to transfer cash balances from this country or a portion of the Paper Currency Reserve. By a judicious use of the new method this unjust transfer need no longer be tolerated and the interference of the Secretary of State in the matter of remittance is rendered as remote as possible.

Finally this method is evidently suitable and simple and the Exchange Banks need not depend on rediscounting their bills in London but promptly sell their sterling balances to the Government of India and thus replenish their rupee resources in this country.

Disadvantages.

This method is not however free from defects altogether. Firstly, the upper gold point may not be reached at all under this method if rupees are released at $\frac{1}{32}$ d. lower rate than the upper gold point of the rupee. This means the free flow of gold can be diverted and impeded thus checking or restricting the automatic action of gold entering the currency system and rupees or notes issued against that stock of gold. The price can be so arranged as to check the flow of gold. It is not here assumed that the gold would enter the Indian currency media or become a part of the currency of India.

Secondly, it is possible that the Government might not follow the lead of the market but actually set the pace themselves. It is too closely interwoven with the currency policy and absolutely dependent on the Indian money market.

Thirdly, unless the purchase of sterling is definitely limited to actual or prospective requirements the free flow of gold into the country would be stopped. The magnitude of the purchase can be so arranged as to prevent the flow of gold into India. Enormous purchases can be made to cover (1) the amount necessary for the Secretary of State's expenses, (2) the further amounts as can be spared in a prosperous season towards the reduction or avoidance of debt in England, (3) the requirements of trade. But if great funds are remitted to the Home Treasury it would be locking up Indian funds in London. With the right or improper use of these funds we are not concerned here.

Fourthly, the public tender system at four different places means delay involving the collating of different demands at one centre and though the time element can be overcome during these days of electric telegraph, foreign centres dealing with India would be at a disadvantage under the tender system in India. A large number of American people enter into jute contracts and these people would



find it difficult to get along with this tender system. (London being the world's centre application by foreign countries for Councils could be easily made in London.) Under the present system they generally send their requirements at least one day earlier to their agents in India. (There is a big rupee market in London. It is being ignored by means of this new method and hence the best price for the rupee may not be obtained if this market in London is ignored.)

The financial transactions of the Government are being subjected to controversy and criticism on account of this method of remittance. The purchase of sterling to the extent of £1 and $\frac{1}{2}$ mil. on account of the P.C. Department on 14th January, 1928, has been criticised freely. The non-remittance uses made out of this method are likely to be contested strongly by the Indian public.

Finally under this system rupees are released in India by the Government immediately before sterling is placed in the hands of the Secretary of State in London. Unless the credit standing of the parties is of a very high order such a thing cannot be done. The keeping of a Government list means drawing an unfair and invidious distinction which would be resented by the people not favoured according to this discrimination. Although in actual practice no loss was sustained by such a procedure, yet it is not so safe as the sale of Councils which meant the obtaining of sterling in London before the parting of equivalent amount of rupees in India.

Conclusion with reference to the Remittance Programme.

Although on the whole this system has given tolerable satisfaction to trade no time should be lost in starting a Central Bank and handing over this remittance programme to the Central Bank which would pay due heed to the needs of the market while remitting funds to the Secretary of State on behalf of the Government of India. The Central Bank should accept unlimited amount of gold in India at par and issue Bank currency at the upper gold point against it and release unlimited quantity of gold at the lower gold

The system of govt management of remittance should be given up.

point of the internal currency unit offered to it in India. Its acknowledged object should be to check fluctuations in exchange automatically by the free inflow and outflow of gold. Governmental interference in the management of remittances should not be tolerated in any manner. It is bound at certain times to be as iniquitous as interference in the management of currency.

The Sterling Loan of 1927-28 :

Dangers of External Borrowing.

Public borrowing has become a most vital part of the system of public finance of almost all important states. While borrowing from private internal investors is advocated freely there is much condemnation of the policy of the Government's contracting external loans abroad. It is not recognised that even an internal loan might become a direct real burden as it transfers wealth from one section of society to another and increases the inequalities of incomes.¹ But it has the merit of retaining the wealth in the country itself. The repayment of external debt means the transferring of wealth from the borrowing country to the lending one, the exact reverse of what took place when the external loan was contracted. In spite of this chief disadvantage external borrowing must be resorted to when the country's internal capital resources have become well-nigh exhausted or, if it is a capital-poor country with little or no resources, to develop the natural gifts or endowments which Providence has conferred on the country. Again a foreign loan removes undue pressure from domestic industries and does not influence adversely domestic prices.² But excessive foreign borrowing not only tends to bring exchange difficulties but may however end in undesirable entanglements specially if the Government fails to repay or repudiate the loan³ of

¹ See Adams, "Public Debts," p. 40, *et seq.*

See Dr. Hugh Dalton, *Public Finance*, pp. 191-192.

² See Alexander Hamilton, *Works* (H. C. Lodge), Vol. II.

³ The only way the States can now hope to practically repudiate loans is by the pursuing of a currency policy detrimental to the interests of creditors.

the wealthy external capitalists. It may lead to invasion and ultimately colonisation of the external capitalists in the territory of the borrowing country. Like Britain's occupation of Egypt many of the American republics might have been under the occupation of the European Governments but for the successful intervention of the United States of America under the guise of the famous Monroe Doctrine. Inter-Governmental borrowing is less dangerous and would also lead to delicate international questions which end ultimately in disputes and wars when the debtor country does not promptly liquidate the loan.

The Policy of the Government of India.

Although it is on these grounds¹ that independent Governments think twice before tapping the foreign capital resources, the subordinate Government of India borrows freely in the L. M. Market and both sterling loans and sterling treasury bills are frequently contracted after securing Parliamentary sanction which is unnecessary in the case of the Rupee loans of the Government of India. But neither the Parliamentary authorities nor the Government advisors in London seem to pay due heed to the well-known principles of public borrowing and the recent sterling loan was floated in direct contravention of these established tenets. It is fairly clear that such a subordinate body as our Government need not feel any embarrassment in borrowing from the politically superior or overlord country.

Flouting Public Canons.

But though any danger need not arise out of this external borrowing any violation of the established tenets of public finance would injure the credit standing and the integrity of the Government of India. The gilt-edged securities would fail to play their normal part or the role of a useful adjunct in the Indian money market. It is not only essential that resort should be had to the external market as the last alternative but the right kind of fiscal policy has to be pursued in the contracting of loans. A contracting of long-term loan to tide over temporary current treasury requirements or seasonal

¹ For a further discussion see my article, "External borrowing for India"—*Hindustan Review*, December 1929—

expansion of currency is evidently unjustifiable. Nor should there be very great dependence on sterling treasury bills for financing permanent needs of either productive or unproductive expenditure. Treasury bills are unfunded or floating debts of the treasury rather than permanent debts of the Government. They should always be paid out of the next incoming revenues. Special care should always be taken to see that they do not accumulate year after year until they are funded into a consolidated debt by passing a consolidation Act. This process is as dangerous as "issuing warrants" on the empty treasury and asking the recipients to discount them at the hands of the bankers who would of course collect them from the treasury as soon as it is reimbursed by the payment of taxes. The "shaving of warrants" always develops into a serious abuse and there is no reason why the Treasury should not properly liquidate all claims upon it. The most important thing in public expenditure is that what is chargeable against revenue must not be charged against capital or what is chargeable against capital must not be charged against revenue. The difference between the transactions in credit and transactions in capital must be grasped and practical finance must pay heed to this distinction.

Recent Sterling Loan.

It is inexplicable why these ordinary canons are deliberately flouted by the financial advisors of the Secretary of State for India or why Parliamentary sanction is granted in such cases. Do they still continue to be sleepy guardians of our teeming voiceless masses? In as much as Sir Basil Blackett studiously refrained from foreign borrowing during the early years of his stewardship it is only recent instances of 1927-28 and 1928-29 that would be quoted in support of the above statement. The Controller of Currency states on p. 22 of the current report of his operations that, "in January, 1928 a sterling loan was issued in London to provide funds for capital expenditure on Indian Railways and to repay £5 mil. India Sterling bills maturing on the 29th of that month. The loan took the form of seven and a half millions (£) four and half per cent. stock issued at 91 and $\frac{1}{2}$ per cent. redeemable at par at the latest on the 1st June, 1968, the Secretary

of State for India reserving to himself the right to give three calendar months' notice to redeem the loan at par on the 1st June, 1958, or any other half-yearly interest date thereafter. The loan was fully subscribed on the day it opened."

Here is tacit admission by the official spokesman that maturing Sterling Treasury bills are being repaid by a regular long-term loan, a practice that has to be severely condemned for it leads to contracting regular loans for meeting current expenditure. Long-term borrowing is to be contracted only for executing public improvements which cannot be paid out of current revenue or when emergencies like wars involve huge expenditure which cannot be met by revenue from taxation. Prof. A. C. Pigou says "It is generally agreed that the funds for Government expenditure devoted to producing capital expenditure.....the fruits of which will subsequently be sold to purchasers for fees ought be raised by loans."¹ If only the whole of the loan was needed for railway expenditure it can be easily justified. But a part of it was utilised for paying off maturing treasury bills, i.e., temporary borrowing.

Temporary borrowing during the course of an year is justifiable specially during days of greater expenditure than the collected revenue. "Deficit financing" is now given up as unsound policy and a bad expedient and if it is pursued each year it can only be put an end to by consolidating the indebtedness into regular long-term loans. The balancing of the budget is now the accepted future of public finance and one year with another the surpluses and the deficits ought to balance. Again there should be systematic arrangement of the different forms of debt when a constant use of them is being made and strict business principles should be followed in the matter of borrowing either by the treasury or the Government. Opportunities

¹ Dr. Hugh Dalton however considers that it might be advisable to finance a large part of the capital expenditure if it is possible to do so by means of taxation as "it prevents the breeding of needless unearned income and makes for a less unequal distribution." It should be "one of the prominent features of the Public Finance of England as well as that of other countries," says Hugh Dalton. It is only the underlying truth of this statement that made Sir Basil Blackett remark that he would like to finance unproductive expenditure such as building New Delhi out of pure taxation revenue alone instead of by loans. See the Assembly Debates, Vol. III, No. 48, p. 2931.

should be afforded for all classes of people to invest in the public debt. Although Adams ¹ says that a widely diffused debt does not indicate a healthy condition of political and industrial society still desirable social consequences can be reaped.

Bluffing the Public distorting the Truth.

It is also apparent that it is not the recognised policy of the Government to place reliable information as regards the object of floating the sterling loan. The Special Representative of the Statesman in Delhi inspired from official sources was publishing the information that the above loan was meant "to strengthen the Reserve Bank which would be launched forth during the year." ² No comment is needed on this deliberate distorting of truth. It is also stated "that the sterling loans are floated when conditions are usually not very favourable as in October and November. They are floated in January and as a result of firm conditions prevailing in London higher rates have to be paid." But as Sir George Schuster says it is in January that financiers give the best attention to these loans and better rates can be obtained in January alone.

Still another Example.

A contrary instance of contracting sterling treasury bills to finance capital expenditure would complete the case against the unsound financial management. Quite recently in the current financial year 1928-29 Six Millions £ Sterling Bills were floated by the Secretary of State not only to augment the Home Treasury Balance but to meet the pressure for financing Burma Railway Requirements. The Statist pointed out this anomaly and instead of pursuing the right method of contracting a long-term loan to finance capital expenditure treasury bills were floated to finance it. The right occasion for contracting treasury bills is when there are no funds to repay the maturing treasury bills. Why should there be the persistence in this unsound policy? Of what avail would it be to pursue this

¹ See H. C. Adams, "Public Debts," p. 43, *et seq.*

² See the Statesman, November 29th, 1928, Money Market Review.



hand-to-mouth policy based on mere opportunism rather on a thorough understanding of the tenets of public finance ?

Rumour of another Sterling Loan.

Now that there is a rumour in the Clive Street that a £10 mil. loan is about to be sprung on the market as a surprise¹ it behoves us all to know the real reason why it is to be floated. When in India a very big loan—the biggest single rupee loan ever floated in this country—was successfully negotiated why was not this additional sum for capital expenditure added and secured from the Indian Money Market. Perhaps the whole of it is not meant for capital expenditure and a part may be made to repay the maturing treasury bills (Six Mil. £). Inasmuch as the present financial conditions are very firm in the London Money Market the exchange bankers would not draw on their London sterling balances and thus enable the Government of India to purchase sterling on a large scale and remit the funds to repay the maturing sterling treasury bills. The success of the policy of the purchase of sterling to finance the Home Treasury is dependent not only on the Indian cash balances in the Indian Treasury or the Imperial Bank, but on the conditions prevailing in the Indian as well as the London Money Markets. It is only when remittances to the Home Treasury are insufficient that recourse to the treasury bills is justifiable. The policy of purchasing sterling in India will have the defect of forcing the Secretary of State very often to have recourse to the Sterling treasury bills if the remittances cannot be made at the proper time owing to weak exchange conditions in the Indian Money Markets or very firm money conditions in the London Money Market which make the exchange banks and other financial houses unwilling to part with their sterling resources.

Secondly, the remaining £4 mil. will be used to purchase sterling securities which being placed in the P. C Reserve would entitle the Government to expand the P. C. in this country to satisfy the requirements of the busy season. This again is a makeshift device and so long as the Government continues to be the currency authority this method of seasonal expansion would be resorted to. This is as bad

¹ See the Statesman, December 15th, 1928, Money Market Review.

as the expansion of currency against the creation of *ad hoc* securities of the Government of India and placing them in the P. C. Reserve. The only honest and desirable way of meeting seasonal expansion is to create the C. B. of issue and empower it to meet seasonal demands without any undue raising of the bank rate. The evolutionary trend of international and foreign banking is in this direction. India must continue to learn the desirable things of the West and adapt them to suit her own domestic conditions.

It would be far more rational to ask the Secretary of State to utilise the G. S. Reserve for meeting his temporary requirements and after the pressure is over due readjustments of the funds can be carried out as soon as possible. This was actually suggested by Sir M. Hailey when he was Finance Member in 1919-20. Similarly the G. S. Reserve can be made to help the P. C. Reserve during seasonal times. The question of limiting the G. S. Reserve to £40 mil. and adding the rest to P. C. Reserve to wipe out the created securities is too well-known to need any repetition. There is also no clean cut partition in the practical operations on the Reserves, the P. C. Reserve and the G. S. Reserve. So it would be not wrong to suggest this use of the G. S. Reserve fund. Till a complete amalgamation of both according to some comprehensive plan of currency reform is forthcoming this use of the G. S. Reserve would not be unjustifiable. The separate standing of both the Reserves can be kept up if it is liked and as overlapping is more often the case why should not the G. S. Reserve help the P. C. Reserve specially during the emergency season?

Conclusion.

There are periodic outcries on the part of the Indian public and the Press against contracting sterling loans. It is as a concession to this agitation that the policy of floating rupee loans is placed in the hands of the Government of India and a wise Finance Member like Sir Basil Blackett always yielded to popular clamour in this respect. But why again are very big sterling loans contracted in London almost defying public opinion in every respect and flouting the canons of public finance? Before the recent war no Rupee loan was contracted for a higher figure than five crores of rupees. Of late the

amounts of rupee loans are increasing thus showing that the tendency of the Government is to borrow more and more in India. Instead of continuing this very desirable tendency what is the reason to change this policy? Is it to advertise to the world that London has once more regained the golden sceptre of finance and that foreign investments are being made as in the pre-war days? Whatever might be the inner motives underlying the contracting of sterling loans which are known only to the financial advisors and cannot often be justified on the accepted principles of public finance there is no reason on the part of Government of India to persist in this unwise policy. It should yield to popular wishes in this respect and create a Central Bank of Issue and count upon its sagacity to solve these problems. This hand-to-mouth policy has to be given up. Dependence on the ways and means advances to tide over temporary requirements is far preferable to this policy of muddling through somehow or other. The remittance programme can be entrusted to it and when adequate funds are remitted without causing any disturbance to the Money Market, there need be no occasion to resort to the contracting of sterling treasury bills in the London Money Market. It would also lead to a development of the Indian Banking System and enable the Government of India to count upon the resources of the Indian Money Markets to secure the full quota needed for their increasing capital expenditure requirements. It would enable the Money Market to function smoothly and the seasonal demand for emergency currency can be created on a sound and business-like basis by the Central Bank of Issue. All roads lead to Rome and if banking currency and financial reforms are to be achieved it can never be done without a Central Bank of Issue.

The Defects of the New Regime.

Doubts have already been expressed as regards the automatic character of the gold bullion standard as managed by the Government at the inauguration of the scheme itself. It would be no exaggeration to say that they have been realised up to the hilt and the following are the most glaring defects of the scheme as observed during the short period of its actual experience in India.

Till the Central Reserve Bank is started and is constituted as the currency authority managing the G. B. standard system it is not possible to secure any improvement.

The new bank paper which ought to form the framework of the ideal currency structure has not yet been ushered into existence. The Government paper currency is a note payable in silver rupees which are considered as metallic notes. This currency anomaly has to be cured one day or another and the concept of the *gold rupee* even though it would be unrepresented by any actual physical counterpart of its own would have to be popularised. It would be impossible to forecast the attitude of the masses towards this new inconvertible¹ legal-tender bank note to be issued by the Central Bank but as they seem to have received sufficient education already in the use of paper currency they would not seriously entertain mistaken notions as regards the new government guaranteed inconvertible currency that would have to be circulated under the gold bullion standard system. Even in Egypt the illiterate farmers did not doubt the character of inconvertible currency that was issued during the period of the recent war. Probably there may be a slight discount to the notes attached at the beginning and the demand for silver rupee might also increase but a persistent attitude in the matter of forcing in this new circulation would make it popular. Inasmuch as the Central Reserve Bank has been vetoed the currency authority should not now undertake the introduction of such a note.

The acme of the gold bullion standard is its simplicity and with the simplicity of functions the unification of the reserves has been advocated. As yet the banking and the currency reserves have not been amalgamated and in the absence of the Central Bank of Issue there would be no such fusion. But there is no reason why the currency Reserves should not be amalgamated in the hands of the currency authority. The P. C. Reserve and the Gold Standard Reserve are very often used for self-same purposes though ostensibly each has a set task to perform. The non-convertibility uses of the P. C. Reserve need not be commented upon and the Gold Standard Reserve

¹ As conversion of the same into gold bullion can be done on a large scale only it is considered practically inconvertible. The *de jure* conversion into gold bullion exists but there would be no *de facto* conversion of the same note in small quantities.



is not drawn upon only in the emergency of an unfavourable trade balance. As both are looked upon as one common fund available for the support of the exchange it follows clearly that there should be a fusion between the two. The attendant disadvantages are not overlooked¹ but some heroic step has to be taken in order to increase their usefulness by making them freely available to the currency authority in the time of need. If the analogy of foreign countries is taken into account even the gold exchange standard countries have one central reserve in the hands of the Central Bank. It might however be argued that there is no interesting comparison between India and these countries. There are indeed considerable practical difficulties such as the conversion of silver rupees into gold or equivalent foreign exchange and notes convertible into silver rupees or foreign exchange as above. But the single currency reserve must continue converting notes into rupees and converting both into foreign exchange. Hence silver coin as well as bullion, rupee securities, sterling or gold securities and gold would have to be kept in the reserve. It is however impossible to fix the gold and gold securities that would have to be kept so long as the silver rupee is unlimited legal tender. The amount of special rupee cover required for the whole of the outstanding silver rupees if the present currency gauge is changed cannot also be determined with any certainty. The silver rupee contains silver bullion to a great extent and contains some cover within itself. Additional coin would have to be kept for fresh issues of rupees and it is not essential to maintain full cover for the nominal value of these rupees. If a modest estimate is framed for the liabilities for the outstanding stock of rupees a balance would be available which would be used as suggested by Sir B. P. Blackett for capital expenditure on reduction of sterling debt of the Government of India or this surplus may be retained by the Government in the form of silver bullion or coin. Hence a unification of the different reserves into a single currency reserve is an advantageous measure and is likely to be beneficial to the operation of the present standard.

¹ So long as the notes are legally convertible into silver rupees there should be a P. C. Reserve the bulk of which should consist of silver rupees.

There is not and cannot be any automatic expansion and contraction of currency if there is no efficient discount policy of a Central Bank of Issue in the country. Mere stabilisation of the rupee at a fixed parity does not tend to make it automatic and although the requirements of foreign trade can be looked after by this policy the internal trade requirements which are roughly ten to fifteen times greater than that of foreign trade would remain unsatisfied by this programme if it is unaided by the discount policy of a Central Bank of Issue.

As the silver rupee is still the king holding undisputed sway in the internal currency system of the country a possible danger, however remote it might be, lies in the possibility of a rise in the price of silver. With the new parity of 1 s. 6 d. per rupee the silver rupee becomes a full-valued metallic coin as soon as the price of the fine ounce of silver rises to 48 d. It is indeed a big jump that would have to be accomplished if this high value is to be reached. But if India continues to be the final market for silver as in the past there is no knowing what might take place in the unknown future. The object of the currency authority should be to make the system absolutely "fool-proof or knave-proof." But with this contingency looming in the horizon it cannot be stated that even this new and high ratio would tend to make the silver rupee safe from the melting pot for all time to come.

Another thing which the action of the currency authority has brought about is the fall in the price of silver. By this the Indian people stand to lose a portion of their savings which has been converted into silver. What definite action has been taken to protect the interest of these people is not apparent. The mere abstaining from the sale of unwanted silver would not suffice.¹ The sale of alloy silver might be brought about to contract currency and reduce imports of silver into the country. Inasmuch as low-priced silver tends to increase the industrial consumption of it by the people they would stand to lose by this step and the rupee coin also becomes a cheaper token.

¹ In the last sale of silver the Government sold it through the London brokers in foreign markets.

The Silver Situation.

With a definite pronouncement that India would have a gold bullion standard and that dependence would be on bank-note, the Government of India with its large present-day holding of silver cannot hope to be a buyer for a long time to come. As silver is not likely to rise greatly in price without the Government of India buying it for coinage purposes so also it is not likely that it would fall if the Government were to abstain from selling it for any of the abovementioned purposes. The assurance that it would not sell silver quietened the tone to a great extent and the price has risen from $24\frac{1}{2}d.$ to $26\frac{3}{16}d.$ per fine ounce. The pre-Hilton-Young Commission price was roughly about $29d.$ per fine ounce and until that is reached the sale of silver would be inadvisable and although speculative movements initiated in China or the sale of silver by other countries such as France would have an effect on the price of silver still the stolid determination on the part of the Government not to sell silver for contracting currency has to be continued. As soon as it is reached the sale of silver by means of tender as in the case of the purchase of sterling should be adopted. As the Indian people generally hold large stocks of silver for industrial consumption the Government should adopt this policy of selling it by means of public tender. Both the Government and the people would stand to gain by this method. The people can gain by avoiding double expense on brokerage, freight, insurance and other charges. As suggested by Sir B. P. Blackett the reimposition of import duty¹ on silver would prevent India becoming the dumping ground of silver, maintain prices and enable the Government to sell silver at satisfactory prices.

Under the new regime no steps have been taken to counteract the hoarding tendency of the people. It is indeed true that no currency system can be made immune against this pernicious habit and unless a change in this habit is brought about the efficiency of either the genuine specie gold standard or the G. B. Standard would be undermined. As it is an age-long habit it would perhaps take several

¹ Import duty existed on silver at the rate of 5% *ad valorem* from 1894-1910. Again it was imposed at the rate of 4 as. an oz. from 1910-20. In that year it was removed.

decades to wean the people from this uneconomic habit. At any rate no new and special measures have been undertaken to increase the investment habit of the people.

The new system as well as any other currency system in India is liable to receive a rude shock during days of favourable balance of trade. As gold or local currency comes in as payment for exports the great demand for currency during such times has to be provided. Under the present habits and requirements of the people and as the Indian money market is generally very sensitive to contraction no automatic standard can dare to bring about the full amount of contraction that would be needed so as to make the system elastic. But still it is the duty of the Government, to strengthen the gold resources in the currency reserve if there is a net favourable balance of payments.

Suggestions to improve the System.

As the question of the Reserve Bank has been left unsettled the currency authority is "managing" the system and an attempt has been made to indicate the new innovations introduced and their probable consequences.

It is the duty of the currency authority to facilitate the transition to the gold bullion standard stage. The currency authority would have to give the minimum amount of gold bullion (40 tolas) in exchange for its notes and silver Rupees. The most illogical obstruction in the path of Indian currency reform is the silver rupee and if the currency authority were to still further saturate the currency system with fresh rupees the final goal of the gold standard would have to be postponed. Dependence should be solely placed on *the paper note* and not the silver rupee and both of them should be convertible into the minimum quantity of gold bullion. The ultimate demonetisation of the rupee is inevitable under any scheme except the silver standard and the currency authority should be preparing the way for the realisation of this cherished ambition.

The present-day currency authority must take every means to perfect the inland bills of exchange and create an active discount market as these inland bills of exchange would have to be used as part of the basis of the fiduciary portion of the bank note currency in future. Banking facilities must be encouraged and there



should be free and ungrudging co-operation between the currency authority and the money market. For the present the latter has not understood the function of Treasury bills and the former anxious to maintain stability of exchange under any difficulties is not paying proper heed to the needs of businessmen. The Central Reserve Bank should not be ushered into existence at such a time when the two look upon each other with distrust and suspicion.

The currency authority must be prepared to give exchange not on one gold market alone but some other important centres also. In the past exchange of one single market alone was given. This broadening out of the exchange standard would be a better substitute for the existing ones. Although this is to be borne in mind there should not be too much scattering of the gold resources of the currency authority. In view of the fact that India normally possesses a favourable trade balance there need not be a scattering or diffusion of the reserves and too much of gold need not be held in these few foreign centres even.

Finally the sterling loan programme should be undertaken only when the rupee loans have failed to provide the needed money.¹ Preference and full facilities must be given to the holders of existing Government bonds and Treasury bills to permit them if they so desire to subscribe to the new loan and cash applicants can then be considered. The object of this suggestion is not to force contraction of currency by giving preference to cash applicants instead of holders of existing bonds. That contraction of currency would undoubtedly have a reacting effect on weakening exchange is undeniable but unless this preference is given to holders of existing bonds it is likely that the required resources may not be obtained. If the local money markets fail to respond and heavy rates are required for floating even Treasury bills here recourse to sterling loans would be undertaken in spite of the many advantages which the policy of internal loans confer on the country. While resort to sterling bills or short-term borrowing can be easily justified on the score of a depleted Home Treasury and

¹ In 1928 the loan programme was successful and 35 crores of rupees, the actual loan that was floated, was subscribed to in the Indian money market in spite of carping criticism at the hands of the Bombay financiers. 22 crores cash was paid by the subscribers and the rest was obtained by conversion of 1928 bonds.

pressing obligations such as repayment of sterling bills, the floating of sterling loans or long-term loans is contrary to Indian public opinion, and should be avoided as far as possible. The public debt policy of the Government of India should be a consistent one.¹ The gilt-edged securities always form an important part in the money market and help to confer the much needed liquidity to funds in the money market. The sale of securities would secure the funds needed in the busy season and in the slack season other unemployable funds can be used to purchase gilt-edged securities. If the Government's financial and credit policy is vacillating no such confidence would be created in the holders of the gilt-edged securities and these would not play their normal function or part in the Indian money market.

The Hilton-Young Commission's programme is an indivisible whole. It is impossible to achieve significant success by carrying out certain recommendations for adoption and rejecting the others; nor must there be undue delay in giving execution to the well-devised plan. It foreshadows a workable solution of the currency problem and it is so framed as to facilitate the organising of a comprehensive banking system as soon as circumstances make this possible.

¹ It is ridiculous to float a sterling long-term loan to repay maturing Sterling bills. It would be more consistent to renew the sterling bill for a further period rather than float a sterling loan. Yet in 1928, January, a sterling loan was issued for 7½ mil. to provide capital expenditure and repay sterling bills (5 mil. £) maturing in January.—See the Report of the Controller of Currency, p. 22 (1927-28).

CHAPTER XIX.

THE ORGANISATION OF CAPITAL.¹

What is capital? The Indian capital market. Regrouping of productive factors. Sources of capital. Economy of Public and Private Expenditure. Social credit. Purchase of stores. The flow of external capital. Some estimates of external capital. Economists' objection to foreign capitalists. The example of other countries. The example of Eastern countries. The example of the Colonies and the Dominions of the British Empire. The necessity of capital in India. Means for the development of capital resources in India.

What is Capital.

Capital is the power-house that supplies the energy to the industrial machine. India sadly lacks both human as well as material capital. By human capital is meant knowledge, skill, experience and genius. Conservation of human capital is no less necessary than the conservation of natural resources. Material capital is no less indispensable and as a matter of fact it paves the way for the realisation of the other. If the examples of England¹ and the United States of America are considered we find a vast increase in material wealth taking place in the 18th and 19th centuries which led the way to improvement in public health and an expansion of "human capital." Material capital or "capital fund," as Prof. J. B. Clark would put it, consists of the fixed and circulating capital of the country. Material capital is wealth withheld from consumption mainly in order that it may be used for the production of further wealth and, as Ramsay Muir says, "in a complex industrial society the nation has to set aside year by year about $\frac{1}{3}$ of all the wealth for the purpose of keeping our industries going and expanding them. If it failed to do so it would be faced by ruin just as the whole world would die of starvation if all the farmers used up all their crops instead of keeping back a part for

¹ A portion of this chapter was first submitted as written evidence to the External Capital Committee in 1925.



seed."¹ In all economically progressive countries material capital goes on increasing as a result of saving and investment.²

The Indian Capital Market.

The economic welfare of society depends on the perfectness of its capital market. A well-organised capital market would mobilise capital and place it in the hands of business ability for its effective utilisation in production. The two elements of economic production, namely, capital and business ability, might be differentiated and the supply of one ensures the creation of the other. The agents and the capital market consider it their duty to bridge "the economic distance between those who possess capital but lack in business aptitude and those who possess the requisite business ability but are incapacitated for lack of funds." Thus the entrepreneur can arise if there is a capable intermediary securing the necessary flow of capital from one hand to another through its own channels. The task of mobilising, multiplying, and distributing the capital resources into the hands of businessmen and entrepreneurs who put it to a productive use is the work that is expected out of the capital market.³ Credit is the real lubricating oil in the whole financial mechanism of the country. The businessmen by virtue of their credit are able to construct a credit structure many times the amount of cash or legal tender money they hold in their hands. Their credit enables them to multiply the capital they possess together with what they obtain as deposits, fixed or current, into effective means of payment which would enable the society to perform its money's work with the most elastic, least costly and highly efficient cheque currency.

In India owing to the absence of a well-organised capital market business and industrial undertakings can be effectively started only by those who combine both capital and business ability in their hands

¹ See Ramsay Muir, "Liberalism and Industry," p. 44. The total wealth earned in England in 1913 was about £2,000,000,000 and £400,000,000 were set aside for the creation of the new capital and keep the machinery of production going.

² See L. C. A. Knowles, "The Industrial and Commercial Revolutions in Great Britain," p. 168.

³ F. A. Lavington, "The English Capital Market," p. 289.

"entrepreneur-investors" as they are known. Such rare coincidence of both the factors of economic production in the very same hands, is mainly responsible for the partial utilisation of the raw materials which nature has lavishly bestowed on this country. Taking the case of England, the banks, issue houses, accepting houses and foreign exchange departments of the banks are all connected with either the collection of capital or the transporting of it to those who can make a better use of it. The existence of each of these specialising factors reduces the cost of the service that lies in the effective transfer of capital and would give perfect guidance to real investors. The present ignorance of the investors and their fear to undertake risks in the matter of investments are the real obstacles and these can be removed only by the development of an organised capital market consisting of several agents with the ability to minimise the risks and uncertainty in the matter of capital investment. This would increase the efficiency of production and the national dividend. The Indian Government has to do much in this matter of affording protection to the ignorant investors from the dishonest professionals by copying the principles embodied in the German Civil Law which prohibits that companies' shares of a lower face value than marks 10 from being floated. As Prof. Mitchell says, "the public regulations of the prospectuses of new companies, legislation supported by efficient administration against fraudulent promotion, more rigid requirements on the part of stock-exchanges regarding the securities admitted to official lists" are required in this country.

Regrouping of Productive Factors.

It is not only in the field of labour that specialisation, division of labour, ability and special training are adopted and adjusted to the actual needs of the day but the same is the case with capital and land. The natural advantages of land, i.e., its climate, site and soil, are taken into account and the services of the producing agent are concentrated on a narrow range of functions. Coming to the transport of capital a continual adjustment of its supply to demand or the volume of money work has to be done. The sense of combination, business organisation and the ability to regroup the productive agents so as to

produce highly specialised services are not instinctive, inborn or natural gifts. Any country can learn or acquire these faculties as the U. S. A. has done. Japan followed the model of Germany. "Born at the same time as modern Germany it has conformed itself to the German political system, the German conception of the great game of Welt-politik and the German method of playing their game, and German efficiency as a method of national expansion."¹ In Japan the Government is closely allied to the trading interests. "Even the introduction of new industries such as spinning, ship-building, cement, and glass was contrived by the setting up of Government factories which were afterwards sold to private owners. A higher council of agriculture, commerce and industry including businessmen is supported financially by the Government and the Government sends out many special trade investigators to foreign countries." Thus the lack of capital and enterprise on the part of the people has to be rectified to a certain extent by supplementing their resources by Government subsidies and financial assistance to the industrialists. Regular banking facilities have to be multiplied manifold as early as possible if India's resources are to be successfully tapped.

Sources of Capital.

Indigenous capital has to be accumulated and invested in industrial concerns carried on on modern scientific lines. India cannot hope to gain by any sudden adventitious accession of wealth as in the case of England and Germany. The Industrial Revolution of England has been facilitated to a great extent by the wealth poured into England from India during the years 1757 to 1857.² Germany likewise benefited to a large extent by the French indemnity paid in 1870. These French milliards helped to swell the mounting tide of industrial

¹ See T. F. Millard, *Democracy and the Eastern Question*, pp. 27-29.

² See MacGovern, "Modern Japan" or G. C. Allen, "Modern Japan and its Problems," chapter on "Rise of Industry."

³ This has been estimated at various figures ranging from £500,000,000 to £1,000,000,000. See Brooks Adams, "The Law of Civilisation and Decay" pp. 263-264. See also Digby, "Prosperous British India," pp. 30-31. See Lajpat Rai's *England's Debt to India*—*Contra* See J. C. Sinha, "Economic Annals of Bengal."—

and commercial expansion and the influence of the Zolleverin fostered it to a great extent. India has to save more capital and this can only be done by the upper middle class, the rich Zemindars, successful professional men, highly paid Government servants, millowners and merchant princes. The Indian wage-earner can hardly be expected to save. According to Mr. G. F. Shirras the total monthly income of the Bombay wage-earning family is Rs. 52-4-6. Out of this expenditure comes up to Rs. 47-14-5 which is made up of the following items:—

		Rs.	AS.	P.
Food	...	27	2	11
Fuel and Lighting	...	3	8	4
Clothing	...	4	9	10
House-rent	...	3	11	3
Miscellaneous	...	8	14	1
TOTAL		Rs. 47	14	5

This leaves a balance of Rs. 4-6-6 and this can by no means or stretch of imagination be called saving. Many contingencies arise involving additional expenditure greater than this monthly surplus balance. Expenditure on small charities, and on poorer relations and for marriages or other social ceremonies prevents them from saving. Wages are low and it is impossible for the labourers to accumulate capital. The living margin is small, the saving margin is smaller and capital can never be accumulated by the low wage-earning labourers.¹ If India is ever to reach the highest possible stage of prosperity all the members of the community should be in a position to save a portion of their earnings and employ it for productive purposes. This depends on the fact that all classes have more than enough to satisfy current needs which would lead to automatic economy and the storing of capital to meet future needs or for securing a higher standard of life, or consumption. The average income of the Bombay wage-earning individual cannot be taken as representative of things existing in the whole of India, much less can it be considered as representative of the

¹ The same is the case in the rural areas. Any number of family budgets have been collected in the different provinces and the same tale is repeated by the economists who have conducted these village surveys.

total people of the City of Bombay. At any rate there is this much of truth that can safely be warranted to be true of all the lower classes of people or employees in this country. They lead a hand-to-mouth existence with neither the inducement nor the opportunity to spend their income in the way that is wisest and most socially desirable. As Dr. Marshall would say these lack the "telescopic faculty," i.e., the ordering of present actions in accordance with the future and distant ends. This is not possible for them as the economic reserve in their hands is not much and as soon as it is exhausted household goods are pawned to provide the necessary means for the occasion. Such people can hardly be expected to save and build up capital that can aid the industrialisation of the country. Enforced savings on the part of the low wage-earning people would mean "heavy net costs in the social economy." No part of the economically necessary fund of annual capital ought to be drawn from this sort of saving for "it is literally a coining of human life into instrumental capital and the degradation of thrift in its application to such saving is a damning commentary upon the false standards of social valuation which endorses and approves the sacrifice." ¹

It is the upper and richer class people that can afford to save but unfortunately the so-called rise in the standard of life and its approximation to the European standard is involving the expenditure of more money. The finer and cheaper mill-made Manchester dhoties have supplanted the coarse Khaddar clothes. Costly coats, shirts and banians are being used instead of the old chaddars. The substitution of the Scissors and Imperial Tobacco Company's cigarettes for the home-made tobacco and cigars, the use of China glassware and enamelled ware for the old bell-metal and brass crockery, the fine glossy wear for the old ornamented shoes and foreign footwear for the indigenous sandals, the bottled medicines for the Ayurvedic recipes, strong imported liquors for the indigenous ale and arrack, soaps, perfumery and toilet goods for the home-grown soap-nuts, attar and cosmetics, beet sugar for gur and jaggery, costly athletic goods as footballs, cricket, and tennis implements and billiards for the old fashioned Swadeshi games as *bulchuk*, the expensive toys and amusement items instead of cheap

¹ J. A. Hobson, "Work and Wealth," p. 105.

lacquered ware and wooden toys ; the pianos, harmoniums and orchestras and gramophones instead of the *mridanga*, *dhol*, *dhak* and house furniture, trappings and other outfit on Western lines instead of the simple and plain house-made drawings, paintings, and cabinet furniture is having a three-fold effect. Several of these goods mentioned above have no " survival value " and unless there is a rational selection and conscious control of the factors of consumption which possess definite survival values there would be scope for error and a mere unconscious irrational and imitative selection of goods in the standard of consumption is fraught with danger and disastrous consequences to the individual as well as the social well-being of the community. As Hobson points out " such a standard of consumption is trespassing on the economy of welfare." ¹ Secondly there is a drain on the purse and thirdly indigenous handicrafts and cottage industries producing these goods are languishing for lack of patronage. The importation of these luxuries and tawdry manufactures is increasing the powerful hold of the foreign capitalist interests and even our political interests are subordinated to the economic interests of the Empire. The Empire cult which rules all parties, the conservative, liberal ² and the labour ³ parties realises that India is essential to the Empire and England. ⁴

¹ *Ibid*, p. 117.

² For understanding the Liberal point of view about the advantages of possessing India, see Ramsay Muir, " Politics and Progress," pp. 26 and 27.

³ Lala Lajpat Rai remarks that " Young India should stand by Keir Hardies, Lansburys, and Smillies." But there is no use of this dependence and the first Macdonald Ministry has sanctioned the use of Regulation III of 1818 afresh to curb the existing political situation. He now realises however that political power alone is the cure for our poverty and illiteracy. It is through self-government that Indian nationalism aspires to solve them better than by dependence on socialism and Parliamentary help.

⁴ See A. E. Duchesne, " Democracy and the Empire," p. 48. See also A. Demangeon, " America and the Race for World Dominion." India is a typical colony for exploitation. Immensely rich and thickly populated she represents for her masters at once a fortune and a defence. It is through India that the British Empire assures her destiny. India is the halting place of British commerce to the Far East. India gives the fleet places of support on the sea-route. India recruits for the army legions of high spirited soldiers ; native contingents fight for Great Britain in China and South Africa. During the Great War India supplied more than a million men of whom more than 100,000 were killed. India is for Great Britain an enormous market : two-thirds of her importations come from English sources ; she furnishes 51% of the wheat production of the Empire, 58% of the tea, 73% of the coffee, almost all the cotton. An immense British capital is invested in Indian mines, factories, plantations, railways and irrigation works. India pays the interest on probably 350 ms. £ sterling. India keeps busy an army of British

All these parties recognise the vast array of "Vested interests," the enormous capital sunk in India, the numbers dependent on its returns, the importance of Indian products to British industries, the number of British people employed both by the Government and the commercial firms and the army of English people such as merchants, shippers, distributors, producers and consumers whose prosperity depends on the Indian connection. Any snapping of the link between India and England would lead to a social disaster of no small magnitude and is bound to adversely affect the material conditions of the English people. India on the other hand can to a large extent decrease its dependence in trade matters on English industries by sacrificing the use of all articles of "illth" as Ruskin denounces them. "If there were no luxury there would be no poor" said Rousseau and the luxuries far from contributing to raise wages actually retard their rise.

The richer class people who import these luxuries must sacrifice their luxuries and save the expenditure on trifles, futilities, inutilities, superfluities and fineries of foreign civilisation. They can economise to a large extent on their clothing bill, expensive boots, shoes, Western glass-ware, dietary articles, soaps, perfumery and foreign toys. The imports of manufactured cotton, woolen apparel, liquors, foreign boots and shoes, Western glass-ware, soaps, perfumery and foreign toys, can be seen in the following table:—¹

(Value in thousands of rupees.)

Article.	Pre-War average.	War average.	1919-20.	1920-21.	1921-22.
Cotton M.D.	53,67,69	52,38,12	59,07,93	1,02,12,00	59,93,81
Silk ..	2,76,05	2,77,00	5,92,42	5,59,34	2,98,70
Wool ..	3,08,37	1,81,71	1,59,85	5,53,09	1,22,86
Liquors	2,02,47	2,36,64	3,37,41	4,90,02	3,76,61
Glass, etc.	1,61,92	1,28,02	1,99,81	3,37,62	2,22,49
Tobacco	71,07	1,32,42	2,01,87	2,95,91	1,65,06
Tanned hides, etc.	—	—	5,37,30,20	12,86,21,10	6,64,85,67
Drugs	1,02,63	1,29,02	1,82,50	2,11,28	1,58,37

officials whose salaries she pays and whose savings go every year to Great Britain. She pours into British coffers the interest on her public debt, the pensions of old officials, the government expenses of her administration. More than 30 ms. pounds sterling a year is the estimate of the sums that India pays in the United Kingdom to her creditors, her stockholders and her officials. And we do not know how much she brings to the merchants who trade with her and the shippers who transport her goods. Never was the term exploitation better applied." See also A. Demangeon, "The British Empire," pp. 238-239.

¹ For detailed figures of the other luxuries see the Review of the Trade of India, 1921-22. Recent figures can be obtained by studying the above annual publication.

India generally exchanges its necessities of life for such luxuries as these. The economic meaning of swadeshi is to hit hard the economic imperialism of the "videshi" commerce and to relax its tightening grip on the vital raw materials of our country. The economic happiness of our weavers and other handicraftsmen can never be realised unless the Indian people resort to the swadeshi movement. Swadeshi is a positive measure contributing something towards the real revival of the home handicrafts and quasi-industrial pursuits. Economies in the matter of luxuries, superfluities and inutilities are to be made and the money saved has to be liberated for providing capital. It tends to create an atmosphere favourable to industrial development. Some advocates have been pleading for indiscriminate protection to create such an atmosphere but they forget the cost it entails on the part of the people.¹

The other deeper and wider implications of the wasteful and leisured rich are beyond the scope of this thesis which is solely concerned with the productive and consumptive uses of the richer classes.² They must be alive to the fact that they hold the "economic nutriment" of all social progress in their hands and instead of applying it to sport, unorganised charity and dilettantism they must turn it into the fruitful channels of art and exercise of life, of thought, activity and of religion. Wise consumption is the be-all and end-all of all economic activity. Ruskin insists on this fact when he says that "there is no wealth but life." This "vital wealth" has to be secured by paying due heed to consumption.³ A wisely arranged consumption can do much to secure the organic welfare of the community.

A simplified system of living is never inimical to the growth of culture or development of art as some of the votaries of the materialistic civilisation think.⁴ Art is only the expression of the emotional stirring in the mind and wealth has nothing to do with the appearance of artistic expression in a society.⁵ To simplify the

¹ See Manu Subedar's Evidence before the Indian Fiscal Commission.

² See Prof. T. N. Carver, "Essays in Social Justice," pp. 273, 379-381; also Prof. Ross, "Social Control," pp. 407-409.

³ See John Ruskin, "Munera Pulveris"—L.

⁴ See the article on *Æsthetics* in *Encyclopedia Britannica*, 4th Edition, Vol. I, p. 285.

⁵ W. T. Sollas, "Ancient Hunters." "The bushmen of Africa reveal a high aesthetic talent in their cave paintings and literary traditions."

standard of living does not necessarily mean any lowering of the standard nor does it mean loss of real enjoyment. A good many things of our consumption can be given up. "To get most out of life is to put the most into it" and it does not mean the surrounding of one-self with all the luxuries and baubles that one can afford to purchase. "Lewdly pampered luxury" tends to lower national character. Moralists as well as economists point out that the chief uses of wealth and the opportunities afforded by a command over wealth are to make a just use of it in commanding art, beauty and culture, secure human well-being and moral elevation.¹ As Prof. Urwick says, "the standard of consumption of the rich people should rest on a basis of organic utility, expenditure being apportioned so as to promote the soundest and full human life. Current Prestige, Tradition, Authority, Fashion and Respectability are not the real things that should displace the individual rational choice in the matter of consumption." Money spent on frivolity, self-indulgence and injurious waste must be turned into the fruitful channels so as to increase our economic energy and improve our social heritage. Money spent on the luxuries is not only unproductive expenditure but goes to the foreign purveyors of these luxuries. If this were to be retained in the country and spent on indigenous manufactured products only a shifting of wealth would result contributing to the accumulation of riches by the *nouveaux riches*. But as these luxuries are foreign articles the loss is a permanent one and the people of the country are permanently affected.² It might be argued that if India refuses to buy the other countries' goods her own exports would decrease. If we decrease imports, exports will be decreased say the authorities on International Trade. But they do not remember one consideration. Our exports are largely made up of those things which other countries

¹ See the Encyclopaedia of Religion and Ethics—Article on Luxury by Prof. W. R. Scott, p. 244.

² Bertrand Russel says the same thing of China. "The development of Chinese commerce by capitalistic methods means an increase for the Chinese in the prices of the things they import which are also the things they consume and the artificial stimulation of new needs for foreign goods which place China at the mercy of those who supply these goods destroys the existing contentment and generates a feverish pursuit of purely material ends."

See "The Problem of China," p. 183.

cannot easily dispense with. This is a position of great tactical strength which ought to be taken advantage of. This does not mean that very heavy export duties should be levied nor does it mean that we must restrict our market by going in for Imperial Preference in the matter of our export trade. The United States impose a high tariff on imports and inasmuch as her exports are largely made up of those things which other trading countries cannot easily dispense with, they are forced to pay this substantial tax to the coffers of the United States.¹ "This might not be what the U. S. A. have intended to do" says Prof. Pigou, "but they are in fact doing this" and he remarks that this is not a generous proceeding.²

Adopting a scientific and more ethical living and social life as our forefathers have done much more capital can be utilised for industrial purposes. By this method alone can India hope to stop the economic drain resulting out of the import of foreign manufactured goods and the scope it affords for the commercial and foreign exploitation of the country. This does not mean that the consumption of goods which minister to the social well-being ought to be given up. English books, English machinery, English industrial skill are necessary and it is the unessential things alone that we must sacrifice. This drain is not due to exploitation but is a result of our own weakness and if our people resolve to buy only the essential things the sellers of rubbish have to put up their own shutters and burn their wares.

If Indian people are really anxious and sincere in their ambitions, for a solid economic and social development nothing is so important as the wise control of public and private expenditure and the proper and profitable utilisation of personal income. The formula of economic retrenchment in private expenditure must be very rigorously preached. The education of public opinion to regard those as

¹ In spite of the increasing customs duties levied under the most rigorously protectionist tariffs, the customs revenues have not fallen and its trade has not been adversely affected. See Prof. Taussig, "Tariff History of the United States," Appendix, Table I, p. 4. Prior to the war the customs revenue amounted to 300 ms. of dollars. Exports continue to flourish in spite of the recent Fordney tariff and the imports do not show any shrinkage. See Bass and Moulton, "America and the Balance Sheet of Europe."

² See A. C. Pigou, "Essays in Applied Economics," p. 155.

infamous who make a misuse of wealth seems to be the only resource we have for dealing with the unworthy rich. At present there is not much progress in this direction. The Indian Government refuses to tax luxuries at a very high rate as the Japanese Government has done.¹ Hence the only effective campaign against these luxuries can be that of educating the people as to their harmful consequences. In modern France the anxiety to build up material capital in order to repair the ravages of war has led even the peasants of France to boycott all kinds of lighting except candles. They have begun to sow more flax and are resorting to the spinning wheel and the handloom to provide their own clothing. In some cities societies have been formed of men who agree not to wear cuffs and collars. In Spain the most prominent single movement is to substitute Catalan Sandals which are a traditional form of footwear used by peasants and labourers in the province in place of shoes."²

From the theoretical standpoint of view several authorities³ on Public Finance advocate heavy taxation on luxuries. Armitage Smith says, "immoderate smokers and drinkers contribute heavily to taxation on account of the consumption of luxuries and it is optional. This taxation raises revenue and imposes no economic burden."⁴ Hume says, "the best taxes are such as are levied upon consumption especially those of luxury; because such taxes are least felt by the people. They seem in some measure voluntary; since a man may choose how far he will utilise the commodity which is taxed."

¹ The Japan Magazine says, "that the luxury tariff bill has become a law in July, 1924. It imposes 100% *ad valorem* rate of duty on all articles included in the luxury tariff. Its list extends to over six pages and a few specimens regarded as luxuries are quoted here. Vegetables, fruits, nuts preserved in sugar, tea, coffee, cocoa, confectionaries, jams, biscuits, syrups, cheese, sodawaters, beverages, liquors, skins, tooth powders, artificial spices, essences, fireworks, wool fabrics, silk fabrics, velvets, waterproof fabrics, handkerchiefs, travelling rugs, neckties, shawls, gloves, stockings, garters, pictures, postcards, locks, keys, cutlery, watches, photographic material, gramophones, firearms, umbrella sticks, walking sticks, billiard, cricket and chess requisites, tennis, baseball, football, toys are all charged 100% duty.

² See The Living Age quoted from the Modern Review.

³ See D. A. Wells quoted in Bullock's "Readings in Public Finance," p. 78, also Dr. Hugh Dalton, "Public Finance," p. 7, also Hobson, "Theories of the New State," p. 121, also Jones, "Taxation Yesterday, Today and Tomorrow," p. 96.

⁴ See Armitage Smith, "Principles on Taxation," p. 92.



Decker proposes a single tax on luxuries to raise all the revenue that the State requires. But this is impossible in this country where three-fourths of the population consume no luxuries. Sir Josiah Stamp proposes levying taxes on the consumption of luxuries.¹ But there is a conspicuous absence of such social condemnation of luxury and waste in our society. The expensive standards of pleasure-getting have to be controlled in our society. There must be a standard of approval and disapproval in the matter of consumption. The standard of approval has to bear in mind the Indian ideals of plain living and high thinking and the standard of disapproval has to check waste, and unwise and harmful consumption.

Economic retrenchment is no less urgent in the public expenditure of the Indian Government. Adam Smith remarked that "great nations are never impoverished by private though they sometimes are by public prodigality and misconduct."² Had he lived in these days he would surely have revised this remark. Dr. Edwin Cannan was correct when he defined 'economy' as the best utilisation of the available means." Our richer classes, flourishing tradesmen and high-waged employees must pursue this ideal of economy. This is not parsimony nor is it opposed to all ideas of progressive expansion and useful development. Our lack of industrial capital forces on us this question of economy and thrift into the foreground of national duties. Besides this reason there is another one why they must give up their love of luxury. "Luxury's contagion, weak and wile" tends to spread downwards from one stratum of society to another with the possible result of a decay of individual and national wealth. It is in the general interest inclusive of their own that these people have to modify their consumption in the particular manner related above. The well-to-do classes can maintain their standard of living but the middle classes would be weakened by their craving for the new wants and desires created by the Western civilisation. To satisfy their cravings by their stationary income living on bad quality of food and sometimes overcrowding are resorted to. This process of "refined starvation" to which the middle class subjects itself and which unfortunately drags itself over a period of years has not been recognised by

¹ Sir J. C. Stamp, "Fundamental Principles of Taxation," p. 74.

² See Adam Smith, "Wealth of Nations," edited by McCulloch, Bk. II, Ch. III, p. 274.

our economists as yet. Attention has thus far been drawn to the state of the working class people alone. The middle class family has to be raised "to a lofty plane of existence pregnant with fruitfulness, learning, achievement, contentment and good-will." If a weakening of the middle classes were to be allowed unchecked the disparity between labour and capital in our country will be accentuated and our society which has thus far been free from the taints of socialistic philosophy or communistic doctrines would soon become poisoned by the presence of those ranks who oppose capitalistic society.¹ There would be an agitation to greater equalisation of the economic conditions of life to be secured partly through extended social legislation which will indirectly affect the well-to-do classes as they will have to pay for it in the long run. Thus the unwise consumption of the rich would not only have a direct bearing on the national strength and prosperity but is bound to lead to unpleasant consequences in the long run.

It is not the waste of money alone that has to be seriously regretted. The waste of time that the richer classes can afford to commit is equally bad. As the Bishop of Birmingham puts it "this is nothing but immoral rest" if the rich people fail to utilise their wealth and employ their time in the improvement of the organic life of society, eradicating civic diseases as bad housing, lowering environments, badly founded education and other evils of the society. The Chinese Philosopher Confucius says, "the rich people should not perfect themselves but strive to perfect others also and this is the fundamental base of all progress and of all moral development" the happiness of the civic life of the community must be striven for by every citizen and the rich people must not only lead model and true lives but seek to ennoble others and level up the rest of the people to their own life of contentment and happiness. This is the "Work-bench philosophy of life" as opposed to "the pig-trough philosophy of life" which advises the human soul thus: "thou hast much goods laid up for many years, take thine ease, eat, drink and be merry."

¹ Dr. Hadley echoes a similar sentiment when he says "the first French Revolution was probably quite as much due to the ostentation of the rich as to the pressure of the government."—*Economic Problems of Democracy*, p. 142.

² See T. N. Carver, "Essays in Social Justice," p. 278.

*The Development of Social Credit increases the
Mobility of Capital.*

Another great desideratum at the present time is the development of social credit as Dr. Marshall would put it. Its presence is absolutely necessary before our society can hope to accumulate large capital. "Social credit arises on account of confidence which permeates all life, like the air we breathe, and its services are apt to be taken for granted and ignored like those of fresh air until attention is forcibly attracted by their failure. It exists as trust in the character of society, in the stability of public order, in freedom from disturbance at home and from foreign attack in the gradual and harmonious development of economic conditions, in the probity of reasonableness of people generally and specially businessmen and legislators in the society and good working of that currency which acts as the medium of exchange and a standard of measure for gauging economic obligations and transactions of all kinds."¹ The development of social credit is indispensable before any unlocking of Indian capital for industrial purposes can be expected. It is slowly developing and the time would come when the Indian people can get together and pull together. It alone can make possible a realignment of industrial conceptions on the part of the people, who being placed in the circle of modern nations have caught their infection of the search for wealth, their keenness for invention and desire for progress, change and innovation. Mercantile and manufacturing business is largely in the hands of foreign capitalists and the accumulation of indigenous capital is difficult. It can only arise out of the surplus of the rich landlords, the high-waged employees of the government and the few people who are engaged in trade and manufactures. The following table shows the annual averages of capital issues in the different countries:

¹ See Dr. Marshall, "Industry and Trade," p. 165.

² See Statistical International Year Book, 1928, p. 207.

Year.	Great Britain (Ms. £)	India (Ms. Rs.)	The United States (Ms. dollars).	Switzerland (Ms. Francs).
1913	41	669	137	528
1923	67	246	4,015	748
1924	89	229	4,587	609
1925	132	342	5,125	675
1926	140	197	5,188	709
1927	176	207	6,203	868
1928	219	282	6,724	688

Foreigners observe that the Indian people have hoarded wealth which is seldom brought forth into circulation. The reasons for this habit have to be understood before it can be pointed out that they should release a large part of it for capital purposes. It has already been pointed out that political insecurity, unfavourable environment, the joint-family system, the absolute dependence of women on the male members of the family, the necessity to spend on social and religious functions, the huge favourable trade balance in favour of India and the distrust of the people in the token currency, have all tended to make the people hoard their capital in the shape of ornaments. The absence of a widespread banking system doing business on conservative lines makes the people depend upon gold and silver as the best means of obtaining money at short notice. The inadequate distribution of the banks and the small scale on which they conduct their business precludes them from extending their branches into the interior and familiarise the people with these new institutions. Though this would first of all tend towards an increase of currency still the banks would be in a position to loan out more funds to industries than before. Thus the development of sound banks in the interior to mobilise as much capital as possible is an important desideratum at the present time.

The Purchase of Stores.

The purchase of stores by the Government of India in this country alone of all its requisites so far as the quality of goods come up to their requirements would be another way by means of which

a large amount of capital would be available for industrial purposes.¹ The Government spends its sterling resources for the securing of these stores in England and if indigenous goods of equal standard with the foreign manufactured goods are to be had the Government should be in a position to make the purchases here alone. The following table shows the imports of Government stores.²

In thousands of sterling.

		1909-10—1913-14	1914-15—1918-19	1919-20
Metals	...	414	946	1,667
Railway plant	...	1864	883	4,462
Wool manufactures	...	...	751	690
Arms, etc.	...	162	704	1,044
Apparel	...	...	475	422
Hardware	...	197	430	870
Cotton manufactures	...	...	342	297
Flax	...	...	291	297
Instruments, etc.	...	121	252	419
Parts of Ships	...	...	185	20
Machinery	...	187	182	447
Chemicals	...	...	149	111
Stationery	...	64	148	271
Telegraph material	...	78	120	579
Drugs, etc.	...	...	101	201
Coals, etc.	...	101	27	1
Other articles	...	672	1,698	1,933
Total	...	3,880	7,634	13,731

¹ The organisation of the Stores Purchase Department has been expanded and agencies have been established in various important centres. The important departments of the Central Government and some of the Provincial Governments purchase stores through this agency. Engineering and allied manufactures, and textile goods are being bought through this agency. In 1924-25 goods worth 259 lakhs of Rs. were purchased in India.

² For details of recent years see the Review of the Trade of India under the heading "Government Stores."

The Accumulation of Capital.

The capital resources of the Indian people have been increasing both in utility and volume and the following table shows the number of companies at work.¹

Year.	No. of Companies at work.	Paid-up capital (000,000) Rs.	Increase or decrease in paid-up capital.
1900-01	1,366	369	...
1901-02	1,405	325	3·8
1902-03	1,440	380	1·7
1903-04	1,488	387	1·7
1904-05	1,550	403	4·
1905-06	1,928	418	3·8
1906-07	1,922	442	5·8
1907-08	2,061	508	14·8
1908-09	2,156	570	12·2
1909-10	2,216	614	7·8
1910-11	2,304	640	4·2
1911-12	2,465	693	8·3
1912-13	2,552	721	4·0
1913-14	2,744	765	6·0
1914-15	2,545	807	5·2
1915-16	2,476	850	5·2
1916-17	2,513	908	6·9
1917-18	2,668	991	9·0
1918-19	2,789	1066	7·6
1919-20	3,668	1232	15·6
1920-21	4,708	1644	33·5
1921-22	5,189	2305	40·2

¹ For recent statistics see the Annual Report of the Registrar of Joint Stock Companies.

But it cannot be accurately ascertained how much of this capital is Indian-owned. As a broad generalisation it can safely be stated that it would amount to $\frac{1}{3}$ of the total amount. It is not as the paid-up capital of the joint-stock companies alone that foreign capital enters India.

The Different Forms in which External Capital enters India.

Human as well as material capital enters India. One thing which escapes the calculation entered into under Indian imports is the fact "that young men are imported and their ability and energy are an advantage to India. England bears all the costs of their nurture and education; while India however reaps the benefit out of this expenditure."¹ India counts all material goods under her exports to England. Although this seems to be an ingenious defence of the economic drain theory one thing has to be remembered. If these skilled imported men make India their land of permanent abode instead of treating it as a "land of regrets," and teach the Indians to acquire their skill and industrial efficiency the prosperity of the country would further increase. In the case of the United States of America it was the skill of the immigrants in farming, forestry, and mining that contributed a good deal towards the industrial development of the country. Material capital enters India generally in the following ways: (a) Subscriptions to Government loans and the loans of quasi-public bodies such as Municipalities, Port Trusts, Improvement Trusts. (b) As capital of the joint-stock companies with sterling capital or as debentures of the rupee joint-stock companies when raised in the foreign country. (c) As the capital of the private business men. (d) As banking capital imported by banks during the busy season.

Estimate of External Capital.

It is not British capital alone that is invested in India. The Japanese, the French, and the American capitalists have also invested

¹ See Dr. A. Marshall, "Money, Trade and Commerce," p. 135.

to a certain extent in this country. Various estimates have however been made now and then to ascertain the amount of British capital invested in India. Before noting the different estimates it is advisable to understand the means by which British capital has been able to obtain a dominating hold over our industrial situation. Mr. C. K. Hobson points out that some amount of capital was exported to India before the 17th and 18th centuries. European relations with India at this time present a flagrant example of the exploitative tendency of capital in the worst possible manner. San Thome is a blot on European civilisation. "By the middle of the XIXth century England began to supply the greater part of the locomotives, steel, iron, timber, etc., for railways in India. At present it owns the bulk of the Indian railway companies' foreign issues." A large part of the Indian Government stores imported by the sea is chiefly supplied by the British Industrialists even now. Towards the close of the XIXth century British capital was driven by the American capital from the New World and was squeezed by the European financial mechanisms, hence it began to push its way to India, to Australia, to Africa, to South Africa and other undeveloped parts of the Empire. At present hundreds of millions of £ (1,500 ms. according to Hobson) of the British investors' money has been poured into this country in order to provide it with railways, irrigation works, to build barracks and forts, to set up gun factories, cotton mills, jute mills, mining and trading enterprises and different industries.¹ With the exception of cotton mills of Western India the keys of all the vital businesses of the country are in their hand. The banking system as a whole is practically their creation. The indigo business is gone. The business of the breweries is languishing. The coffee planting of South India might receive a

¹ Mr. G. F. Shirras estimates that the profits of the Bengal Jute mills during 4½ years amounted to Rs. 31,000,000. As regards the interest that India pays it has been estimated that about 60 crores of rupees would be the annual payment. According to Prof. Shah the following amounts are outgoing as payments to the services rendered to India. Political deduction—Rs. 50 crores. Interest on foreign capital registered in India—60 cs. Freight of passengers paid to foreign transport companies—41 cs. Payment on account of banking business—15 cs. Profits on account of foreign business and professional men—53 cs. Total—219 cs. of rupees. See Prof. Shah and Khambatta, "Wealth and Taxable Capacity," p. 234. Such estimates as these can only indicate the actual direction of the flow of profits and so far as the quantitative estimate is concerned it is valueless.

set-back but they are more than compensated by increased scope in coal and tea business. Owing to enormous growth in population the movement of exports and imports with their numerous ramifications has given scope for the development of the retail trade which is again in the hands of the British capitalists. It is not uncommon to find an importer of Calcutta ready to deal with Claret, Whisky, electric light establishment, printing business, etc. These European tradesmen or non-official Europeans as they are known generally form a potent and transforming energy working for material progress and enterprise but the retention of industrial and commercial profits in this country would augment the capital available for further industrialisation.

Varying Estimates of Foreign Capital.

It is impossible to ascertain with any degree of accuracy the amount of foreign capital employed in India. The first comprehensive attempt to calculate the amount of foreign capital was made by Sir G. Paish in 1911. The following table shows the different estimates.

Author.	Year of estimation.	Where estimated.	Amount.
Sir George Paish	1911	Paper before the R. S. Society ...	£ 365,000,000
The Economist	1911	"Our investments abroad" (Economist, 20th Feb.)	470,000,000
H. F. Howard	1911	India and the Gold Standard...	450,000,000
One witness before the Chamberlain Comn.	1913	...	400,000,000
Sir George Paish	1916	"The New" Yellow Peril by B. Mukherjee ...	390,000,000
Sir Archy Birkmyre	1917	...	500,000,000
Sir David Sassoon	...	...	420,000,000
Sir Lionel Abrahams	1919	Evidence before the Currency Committee, 1919	450,000,000

The task of ascertaining this amount is beset with difficulties, inasmuch as the calculations are more or less in the nature of a

guess-work. As these estimates are a matter of conjecture it is not wise to give currency to the details of their calculations.

Whatever might be the exact figure of the foreign investments in India nobody denies that with the exception of the cotton business of Bombay the keys of all the vital businesses of the country are in their hands. In addition to capitalistic agriculture, *i.e.*, jute and tea, coal-mining, gold-mining, shipping, the promotion of feeder lines for railways, electric light supply schemes and the banking business are solely in their hands.

Why Economists object to Foreign Capital.

Woodrow Wilson says, "a country is owned and dominated by the capital that is invested in it. In proportion as foreign capital comes in among you and takes its hold in that proportion does foreign influence come in and take its hold and therefore the processes of capital are in actual sense the processes of conquest."¹ The late Mr. Ranade pointed out this fact long ago and remarked as follows, "the political domination of one country by another attracts far more attention than the more formidable though more unfelt domination, which the capital, enterprise and skill of one country exercise over the trade and manufactures of another. This latter domination has an insidious influence which paralyses the springs of all the various activities which together make up the life of a nation."² Prof. Scott says that "the compulsory economic dependence on foreign capital and economic subserviency is a more subtle evil than political subserviency."³

At least the key and vital industries of military importance should be kept from outside control. Considerations of national integrity require that Indian trade, commerce and finance must be under their control.⁴ It is a sad and poor complement to the rich Indian landlords, Marwaries, bankers and indigenous capitalists to

¹ See Woodrow Wilson, "International Ideals," p. 78.

See also Dr. C. K. Hobson, "Export of Capital," Chs. XIV and XXX.

² See M. G. Ranade, "Essays in Indian Economics," Second Edition, p. 105.

³ See Prof. W. R. Scott, "Economic Problems of the Peace after the War," p. 27.

⁴ Under this heading should be included Industrial enterprises like iron, coal and textiles and agricultural industry, Banking, shipping, mining and metallurgy.

allow the foreigners to work out our industrial resources. Inefficiency and supineness have given scope to foreign capitalists to worm themselves quite into our economic vitals to the extent of menacing the political future of our people. Economic preponderance and financial conquest, assured for a number of generations, have inevitably given them the political domination. They have created vested interests for themselves and in their anxiety to save these interests they stand opposed to all political parties on the mistaken notion that a national policy might sweep away their interests.¹

Why Foreign Capital is objected to by Indian People.

The present attitude of the Indian people towards foreign capital can be described in the language of Dr. Grunjel. "It is only in the early stages of capitalistic production that foreign investors' capital will be viewed by a country as desirable. As soon as the spirit of enterprise becomes active in the country itself attempts will not be wanting to replace such capital by foreign loan capital which leaves in the possession of the debtor country the excess of its earnings above interest, thus operating to enrich the latter more rapidly and at the same time eliminating the unavoidable personal influence of the foreign capitalist on the domestic economic policy. The most insistent opposition to the foreign enterpriser will be found in the case of those enterprises to which is entrusted the safeguarding of any special economic interest of the community in the field of national defence, of trade, industry and commercial policy."

The first protest against the exclusive domination and sway of the foreign capitalists came from the late Mr. G. V. Joshi² in connection with the extension of railways solely with the help of foreign capital. The late Sir. V. D. Thackersey attacked the employment of foreign capital in the most scathing terms as follows: "But when we turn to the petroleum industry in Burma, the gold mines of Mysore, the coal mines of Bengal, the tea and jute industries, the carrying trade

¹ I use "vested interests" in the sense that T. Veblen has given to it. As he says "vested interests are prescriptive interests or rights to get something for nothing." As an example the action of the Indian Exchange Banks might be quoted. See chapter on Exchange Banks.

² See "Speeches and Writings," p. 638.

by sea and the financing of our vast foreign trade by foreign banks we come upon a less favourable aspect of the question of the investment of the foreign capital. In such cases we cannot but think that it would be to the permanent good of the country to allow petroleum to remain under ground and gold to rest in the bowels of the earth, until the gradual regeneration of the country which must come under the British Rule, enables her own industrialists to raise them and get the profits of the industries.... The price paid is much too great for the advantages accruing from them to the country."¹ Sir T. Holland openly resented the exploiting of the petroleum resources of Burma and remarked that "the drain of profits is an unnecessary and undesirable tax which India must continue to pay until she could find her own capital."² Sir Sankaran Nair, in one of his Minutes of Dissent, says, "we know that there are trade commissioners whose business it is to find out the natural resources and facilities for trade—English trade in particular—that exists in our country. The results of this observation are to be made the basis of expert advice as to the best mode of utilising their resources in the interests of the English trade. It is true that this information would be equally available to the Indian public but we know it is the commercial organisations in England that would be able to utilise them."³ Mr. B. C. Pal writes that the British Government in India though wedded ostensibly to the pernicious doctrine of laissez-faire was really helping the British capitalists in their attempt to exploit Indian resources successfully by giving them facilities through the administration of land laws and rail-road construction, granting or securing mining leases that have been subject to government sanction and favourable land laws as in the case of the Assam Tea industry.⁴ The way in which the indigo planters of Bengal and Behar and Orissa secured official help is too well-known to need any repetition. The imposition of the cotton excise duty, the partial manner in which

¹ See the Presidential Address at the I. I. Conference, 1906.

² See the Report of the First I. I. Conference, 1905.

³ See India Government's Despatch on Reform proposals, March 5, 1919.

⁴ Indian enterprises used to find great difficulty in acquiring land in Bengal. The land laws and the revenue regulations which affect the Board of Transfer of land rights work in practice to the prejudice of the Indian enterprises. It must be recognised that this situation has been improved by the I. I. Commission.

the waggons were distributed during the recent war and the way in which the Government officials are allowed to resign and join foreign private firms and supply information and knowledge supplied to the Government by the firms all over the country and lastly the way in which the Imperial Government used to subsidise the foreign papers and refused to punish the Anglo-Indian papers even when they insulted it, are some of the flagrant examples of the way in which the foreign capitalists¹ have been unduly favoured in this country in the past. Prof. Shah observes that "under the present unfortunate circumstances of India the foreign capitalist is able to command the mystic sympathy of the identity in race even when he cannot boast of a more obvious relationship; he has been able to obtain information and concessions which place him in a position of advantage when compared with the Indian confreres in business or industry. Once entrenched in business or industry he is apt to regard his position and privileges as his property.... The conquest and annexation of Burma were planned and achieved largely if not entirely with a view to facilitate the foreign capitalists in exploiting the petroleum resources of that country. This however is not a solitary instance of *la haute politique* in India being manoeuvred in favour of the foreign element and dead against the Indian interests as the history of our currency organisation² testify." Several of the witnesses before

¹ The Assam Cooly Act which was in force till 1881 was designated by the late Kristo Das Pal as the Assam Slave Act.

See also Buckland, "Bengal under Lieutenant-Governors;" also Misra, "Indigo Disturbances." See Sir Sankaran Nair's Minutes of Dissent to the Reforms Despatch, 1919,—as regards the cultivators distress in the Champaran district.

There was a prosecution of people who stirred up labour in Madras under the Defence of India Act on the plea that industrial agitation has been threatening public peace. This, says Mr. Wadia, was due to the suggestion of the Buckingham and Karnatic Mills engaged in war-work. See "Labour in Madras." Another writer says, "the attitude of the Indian government towards labour is not entirely impartial. It has openly sided with the employers in supplying them with troops to preserve peace in times of industrial dispute but also to coerce and intimidate the labourers into submission." He instances the example of the Madras Government lending 50 members of the Labour Corps to the Electric Supply Corporation to carry on the work and starve the labourers to submission. Mr. Shah says, "Capitalist class consciousness is already apparent and government seems to lead the way in its intensification if we are to judge from the methods adopted in crushing the postal strikes of 1920-21 in Bombay—Trade, Transport and Tariff, paper 179.

² See K. T. Shah, "Trade, Transport and Tariffs," p. 185, also his "Indian Currency, Exchange and Banking."

the Indian Fiscal Commission spoke disparagingly of the foreign capitalists. It is not the educated capitalists alone that resent the intrusion of the foreign capitalists but the educated class and the politically minded nationalists are jealous of the influence of the foreign capitalists. Specially the way in which they have opposed all political progress at the time of the Ilbert Bill ¹ and the resentment at the grant of reforms outlined by the Montford scheme has alienated the sympathy of the educated class.

The Example of the Western Countries.

In Roumania, Chile and Greece attempts are made to exclude the foreign capitalists in their vital national industries.² In the case of Switzerland every foreign insurance company must appoint an agent-general who must be a Swiss citizen and actually reside in Switzerland. By the law passed in August 16, 1919, every foreign insurance company must make deposits in cash and if in securities one-fourth must be in foreign bonds. Italy encourages the investment of foreign capital into the country. Italian companies are allowed to float their debenture bonds in foreign countries. The general opinion in the country favours the contract-cum-loan idea, i. e., foreign companies obtaining contract for construction ^{ive} on a large scale should provide the requisite capital which is required, by certain guarantees of payment of interest and repayment of capital spread over a number of years.³

Even England has scented the dangers of the foreign capitalists' domination over the industries of the country. Many of the witnesses before the Wrenbury Committee of the Board of Trade favoured legislation limiting the portion of capital which aliens may be allowed to hold in joint-stock companies. This Committee has recommended that no restrictions should be placed against foreign capital entering into England for the following reasons. England can never hope to be the world's financial centre in the absence of this valuable

¹ See Sir H. Cotton, "New India" : "The Anglo-Indian agitation against the Ilbert Bill gave rise to a counter-agitation of first-rate importance on the part of the natives. They have learned the strength, the power of combination and the force of numbers."

² See Dr. Grunzel, "Economic Protectionism."

³ See the Report of the Department of the Overseas Trade, p. 39, Dec., 1922.



privilege encouraging the free flow of capital into England. Secondly, political differences would arise between the allies and England if the latter were to close its doors against the entry of their capital. Thirdly, it would result in encumbering trade with heavy pitfalls and meaningless restrictions and technicalities. Fourthly, foreign capital must be given free access into the country, except in a very few instances. On the other hand, there is the advantage of holding this amount of foreign capital as security for England's investments in those countries. By virtue of the Merchants Shipping Act of 1894 no alien is entitled to hold any share or become a part proprietor of a British ship.

The Example of the Eastern Countries.

At first the Chinese Government relied entirely on foreign loans. But towards the end of the Manchu regime a series of domestic loans were issued but the public did not respond cheerfully.¹ The first domestic issue that was actually floated was the Patriotic Loan Bonds of 1911. The first domestic loan that was fairly subscribed was that of the year of the Republic (1914). In fact this issue was oversubscribed. Since then every year a new loan has been floated varying from 5,000,000 to 48,000,000 Gold Dol. More and more the Government has been depending on the native capitalists but as the best security has been already set aside for the Boxer Indemnity and the foreign loans it is difficult to make the native capitalists subscribe to these loans. But since 1921 no large foreign loan has been floated. At present no foreign capitalist can secure any interest in mining companies. Except the technical staff no foreigners shall be employed. For the former the contract must be signed by the ministry of Agriculture and Commerce. No ore-selling contract made with the foreigners shall be valid without first obtaining sanction of the same ministry. The latter has the option in buying the output. In Japan the alien capitalist domination is limited to narrow limits.

¹ See the Year Book of China (1927), p. 133. In the case of the Shantung coal mines it is agreed that Japanese capital ought not to be more than half. In the case of salt and other industries where Japanese nationals were working the Chinese Government has agreed to buy them over (pp. 1172-1173).

*The Practice of the Colonies and the Dominions.*

Some of the Colonies and Dominions as Australia, Canada and South Africa float internal loans and the Governor of the Australian Commonwealth Bank of Australia remarks as follows: "Australia's internal borrowing policy has proved the measure of laying in Australia many millions of money which otherwise would have been sent out of the country." But if her demand for money is urged she has no objection to float loans in the London Money Market. Owing to the congestion of the investment market she has been advised to float the balance of her recent loan in New York. Out of the loan of £20,000,000 floated in July in 1925 only £5,000,000 were subscribed in London; the rest could be secured in New York. Although the Commission charges were a little higher than in the case of London and although the rate of interest to be paid is somewhat higher the loan could be easily floated in a few days. While the net price that could be secured in London was about £96-3s. only £96 could be secured in New York. One compensating feature however is the absence of the stamp duty in New York. In London interest of £5-4-4 per cent. has to be paid; while in New York the net annual interest it has to pay is £5-4-10 per cent. But the chief noticeable fact is the willingness of the American investors to subscribe to government loans floated by the European countries and the Dominion countries of the British Empire. About 551,591,000 dollars were publicly subscribed in the first half of 1924 while about 379,000,000 dollars were subscribed in the corresponding half-year of 1924 (Bankers' credits excluded.)¹ The Australian Commonwealth Bureau of Commerce and Industries remarks that "the Government is anxious to encourage and facilitate in every way the transference of British manufacturing concerns to this country." The same can be said to be the attitude of New Zealand and South Africa. The concessions granted are usually in the form of local monopolies, grant of land, etc., but not much in taxes. Money is needed urgently for the development of their national wealth. Hence their cry for men, money and markets. The present-day economic thought is to bring about a better distribution of the

¹ The Washington Correspondent of the Exchange Telegraph Co., July 19, 1925. Quoted in the "Forward," August 16, 1926.

White race in the British Commonwealth than before. All available capital is to aid this process of migration on the part of men from Britain and thus incidentally solve the twin problems of increasing population and increasing unemployment. The furnishing of men, money and markets is the duty that Great Britain owes to the Empire countries and if this were to be successfully solved there would be all-round prosperity for all the parts of the Empire. Secure of the food-supplies and the raw materials for her industries Great Britain would be free to concentrate her attention on manufactures and regain the lost industrial supremacy which she once enjoyed as the "workshop of the world." Canada places no restrictions against the entry of foreign capital. There are about 675 branches of American factories in Canada doing business in carpet making, steel springs, glass and brush-manufacture. While Canada admits freely the foreign capitalists the Dominion of Australia has recently passed the War Precautions Repeal Act and section 8 of this Act says "no company in which more than one-third of the shares are held by aliens shall acquire any mine or interest in a mine or carry on mining or metallurgical industries." Again it is laid down that "no alien can acquire any share in any company incorporated in the Commonwealth without an express consent in writing of the Commonwealth Treasurer."



The Necessity for Capital in India.

India's mineral resources largely await development.¹ With the exception of coal, iron and gold the other minerals have not been sufficiently developed. The possibilities of developing the forest wealth are very great. Even agriculture requires further development. Capital is necessary for all these purposes. India is an old country and for several centuries her people have been poor. The fertility

¹ See A. Demangeon, "The British Empire," p. 220. See also The London Times, May 24, 1926. One noticeable peculiarity in Canada is this. Five-sixths of the English capital seek Government securities and nine-tenths of the American capital is invested in industrial enterprises. There is also some penetration of American customs and civilisations from the United States of America into Canada. For the present situation, see special article Canada To-day.—The American Invasion, December 5, 1927, p. 15 (The London Times).

of her soil is far below that of the advanced countries. Her population is still predominantly agricultural and they have been noted for their conservatism, lack of enterprise and the unprogressive character of their industrial development. Centuries of isolated and self-sufficient life have taken away the incentive to work and earn more. The nature of the social institutions places so many obstacles in the case of progress that India can well-nigh be considered as the "land of impossible limitations."

The Indian Industrial Commission remarks: "the wealth actually possessed does a very small amount of work owing to its inactivity. The difficulty of raising capital for industries is mainly the measure in India, not of its insufficiency or inaccessibility of money but of the opinion which its possessors hold of the industrial propositions put before them." Thus the chief reason is the imperfect confidence on the part of the small capitalists¹ of India. There is no sustained confidence and it is this that stands in the way of rapid development of banking and leads to incipient runs on the existing banks. It is this that must explain the inability on the part of our industrialists to obtain the necessary capital.

The spirit of enterprise is slowly becoming active in this country and hence the desire is to replace *entrepreneur's capital* for the *loan capital* and to retain in this country itself the *gross* of its earnings above interest. There is a desire to avoid the undesirable personal influence of the foreign capitalist on the domestic policy. Their pride

¹ See the Indian Industrial Commission Report, paras. 55 and 56. Tungsten can be successfully worked in Burma. Chota Nagpur is a wonderfully mineralised country. Copper, manganese, iron, lead, chrome ore, bauxite, mica, graphite, steatite, silica, lime, and ocbres and wonderful deposits of coal of economic importance are known to exist. Owing to the lack of education in the right prospecting methods these resources are not yet opened up. No mining school has been started there to impart the characteristics of minerals, their constituents, field tests, and a proper understanding of the earth's crust. There has been no Chamber of Mines drawing attention to this state and condition of mining. Next to agriculture mining is bound to be the greatest industry of India. But upon this broad foundation of material progress the people have to build up their thrift and enterprise. The possibilities of coconut and bamboo industry are very great. The Government has hitherto neglected to take stock of the industrial possibilities. Its duty is to test, to explore and to prove the possibilities of industrial success and exhort the Indian capitalist to overcome the rooted indifference to industrial enterprise. See also the report of the I.I. Comn., para. 49.



of colour and assumption of superiority, policy of domination and exclusion and general moral aloofness is irritating and galling to the Indian educated mind. They insist on employing their own officers, engineers, and workmen and rarely accord fair, equal and impartial treatment to Indians. Foreign¹ capitalists have settled already to a great extent and indigenous intelligence and skill must take them as their objective models for imitation. The educative value of their presence must not be lost unnecessarily. But if more foreign capitalists were to start branch factories in India as suggested by Mr. T. N. Ainscough it would not help the industrial situation to any marked extent. More riches would flow out of the country and the ultimate benefit which India would derive from these able foreign industrialists would be, as Mr. Chatterton says, "to earn more wages in subordinate positions, by doing coolie work."²

A distinction has to be drawn between entrepreneur capital and loan capital.³ The free flow of loan capital has to be encouraged. When Indian capitalists are already working in the field, permission must be granted to have access to the L. M. Market and float debentures there for augmenting their capital resources. Foreign capital has to seek the co-operation of the Indian investing public and be prepared to assist it with all possible help. While the total requirements for capital are huge, the capital that can be immediately mobilised in India is small. It would be a suicidal policy to postpone the effective working of these resources by shutting out foreign capital from India.⁴ India has to find contact with the International market for the rapid promotion of her public works, specially those of a reproductive nature. The proportion of revenue-earning capital in India is greater than the proportion of non-revenue earning capital. Hence it would not be difficult for the Indian Government to find a market for its loans if it wishes to pay the market price.

¹ See the Report of the Bombay Committee on the rehabilitation of the Government securities.

² See A. Chatterton, "Notes on Industrial Work in India."

³ This is the considered opinion of Mr. Tuke of the Barclay's Bank and a member of the Acworth Committee on Railways. Report of the Acworth Committee, p. 69.

⁴ Joint-Stock Companies of Non-Indian origin doing business in India in the

It is not wise to discourage the free flow of British capital and place obstacles in the way of British enterprise but it is important to remember that ' the sub-conscious promptings of nation-hood ' should not be hurt. This is one of the important problems, says Lord Ronaldshay.¹ The changed attitude of the publicists, economists and the people would have to be noted by the foreign capitalists as well as the Government of India. As the late Dr. Naoroji pointed out long ago, " India sorely needs the aid of English capital ; but it is English capital she needs and not the English invasion to come also and eat up both capital and produce."² Foreign industrial or trade companies might be forced to adopt a proportional representation of Indian Directors on the Board. Those companies that fail to comply with these regulations ought to be taxed at a heavier rate than the other companies. A heavy licensing fee should be charged in the beginning as is done in the case of those banking companies which wish to appoint an agency of their own in New York. For this privilege a foreign corporation has to pay a licensing fee of 250 dollars annually to the Superintendent of the State Banking department. It should also satisfy him as regards its financial stability and its power to open an agency under its foreign franchise. It must make certain returns in accordance with the provision of section 147 of the Banking Law of New York.

Means for the Development of Capital Resources in India.

It has been suggested that foreign capital might be allowed to flow freely into India but that it should seek the co-operation of the different lines are as follows (1920-21). See the Statistical Abstract for British India, pp. 579-80. For recent figures consult this annual publication.

	Rs. Paid-up capital.
Industrial companies	54,98,95,256
Banking and Insurance Companies	19,56,21,552
Trading Companies	44,67,47,165
Total	1,19,29,73,973

Indians might be holding shares in these companies and their share might amount to $\frac{1}{4}$. Again there are companies that are started elsewhere but doing business in India. They number 678 and their paid-up capital is £501,613,574.

¹ See Lord Ronaldshay, " A Bird's-eye View of India."

² Dr. Naoroji, " Poverty and Un-British Rule in India," p. 229. See also G. K. Gokhale's " Speeches,"—Mar. 9, 1911—L. Council Proceedings.



Indian investing public and be prepared to assist it with all possible help. The ultimate object must of course be to enable the Indian capitalists to become the natural heirs of foreign enterprise in this country. For this purpose the investment habit has to be stimulated. Other means to encourage the increase of capital resources have to be simultaneously undertaken so as to augment the stream of capital that awaits profitable work for itself.

(A) The most unfortunate thing about India is that it is not organised socially and economically so as to secure the maximum accumulation of capital. The Indian caste system is neither "a purely economic organisation of occupations nor a chaos of tribes and conflicting races, nor a simple hierarchy of classes, but a mixture of all those unified by the common inspiration which dominates all the groups in their functioning."¹ Birth once for all determines the social status of an individual in the Indian society. Some of these people either by the favour of fortune or by the dint of their intellect may succeed in "breaking their birth's invidious bar and breast the blows of circumstance and grasp the skirts of happy chance." They may grow rich but the inequality of status is a thing that would be never removed. There is no social ladder existing in the present condition of society.² Our social organisation is wholly composed of restrictions, privileges and monopolies. Our women and girls are incapable of realising the evils besetting the social structure. Early marriages, ill-assorted marriages, child-widows and uneducated motherhood still exist in our society. The Indian nation uses only one-half of its citizens, i.e., the males, for social, economic and public service. Hence it is weak as well as poor when compared with other countries. Caste, joint-family system, the depressed classes and the inferior position of women are the strongholds of orthodoxy. The philosophy of *varnasramadharma* is supposed to be the basis of our social theory and organisation, but it does not actually fit in with present-day facts of our society. This meaningless shibboleth of the dead past should be given up. The mere accident of birth ought not to have such a powerful influence on the individual's life. The rigidity of social framework placing impediments in the path of individual progress has

¹ Senart, "Les Castes dans l'Inde," p. 258.

See William McDougall, "National Welfare and Decay," pp. 155-157.

to be toned down. The benumbing influence of pantheistic views of the world, a supersubtle metaphysic and a stagnant civilisation limit the individual's scope to better himself. The creation of a social environment however hard it might be has to be undertaken. Social evolution or reform is vitally interrelated with the question of national efficiency and national solidarity. It would, first of all, make great demands on national or public purse which would fructify in the long run by increasing the productive forces of the country as these agents become more progressive, energetic and intelligent than in the past. An increase in the objective wealth they produce would enable them to save more. At present the greater portion of the Indian people are producing just enough to live on and unless they increase their savings no further social progress would be realised by them. The actual money wages paid must be higher than the general living expenses of the country. This would enable the people to educate themselves and every step in "the direction of perfecting the democratic organisation of society or everything that throws open the world to talent, that finds the right man for the right hole—educational facilities, scholarships, personal agencies—all such things contribute to the perfection of the social ladder by which the ascent of merit and the decent of inaptitude are made easy," has to be welcomed.

(B) The Indian Government or the Board of National Investment has to act as a guide to the investors by compelling reliable information and publishing it for educational purposes. This would suggest the useful investments¹ which people can take up and benefit themselves as well as the society. The state can in this way aid the saver and the society. Beyond the State and Municipal Bonds that are created the State does not concern itself with the other concerns.

¹ The French Government gives indications and uses the private investments of its capital-owning citizens to support national interests of a political character abroad. Thus the Government indirectly indicates the social value of the investments. The Stock Exchange is the only other body that does such a thing and as there are only half a dozen Stock Exchanges in our country it is not possible that they can guide the investors as a body. In some cases capital is being invested in socially objectionable uses as maintaining brothels and adulterating goods and in providing intoxicants. The moral value of the use of capital has to be understood and the State alone can prohibit the non-moral use or injurious use of capital. The capitalist must not be given the right "to do what he likes with his own."



Of course the supervision, conduct and the creation of companies are subject to the control of the State. The Indian Government can do much more in the matter of protecting the ignorant investors from the dishonest professionals by copying the principles embodied in the German Civil Law which prohibits the flotation of companies with shares of a lower face value than £10 from being floated. As Prof. Mitchell says, "the public regulation of the prospectuses of new companies, legislation supported by efficient administration against fraudulent promotion, more rigid requirements on the part of the Stock Exchanges regarding the securities admitted to official lists and more efficient agencies for giving information to investors—all these contribute towards diminishing the possibilities and narrow the range of error made by the incompetent investors."¹ The majority of the Indian investors are gullible simpletons, foolish, sheeplike and lacking elementary notions as regards the difference between sound and fraudulent investments. The State would do well in including such objects as money, savings, investments, and commercial arithmetic in the school curriculum. The importance of savings and its sound investments have to be rigorously preached. The State stands to gain by this wise direction of the channels of savings into permanent employment, affording working opportunities for its people. It would be an indirect method of attacking the unemployment problem in our society. Lack of requisite capital, lack of the right kind of education, lack of opportunity, ignorance where to apply for special work and the possibility of being offered a job in a trade are some of the chief reasons why a great majority of the Indian population fail to develop their own personality or take real interest in the work they do. Mr. Glyn Barlow says "the failures of the Indian Industrial enterprises in the past are due solely to the fact that he has insufficient knowledge of his own industry and lacked intelligence, the shrewdness and enterprise that are necessary for a successful enterprise, or business."²

All statistics relating to the business side of our national life have to be collected by the State and published so that the average chances afforded by every calling can be known very easily. This sort of

¹ Prof. W. C. Mitchell, "Business Cycles," p. 585.

² Glyn Barlow, "Industrial India," p. 32.

action is nothing new. Many governments adopt the policy of supplying information to the labour exchanges free of charge. The Canadian Government realising the importance of agriculture has established the principle of supplying information free of charge to any farmer on any matter relating to his business.¹ The object of making grants towards scientific research, instruction and experiment in agricultural science, says Pigou, follows the same lines.²

The aim underlying such action of these governments can best be expressed in Sir Horace Plunkett's words: "The purpose is to bring freely to the help of those whose life is passed in the quest of the field, the experience which belongs to wider opportunities of observation and a larger acquaintance with commercial and industrial affairs."³ All callings have to be thoroughly studied, catalogued and a proper record established. Their mental, moral, and physical requirements have to be mentioned. This information would be of much value to children and parents. The expenses involved in this collection and publication of information would be very small but the State would be amply repaid as the people settle peacefully in the different callings best suited to their interests and inherent and acquired abilities.⁴ Prof. Kirkaldy says, "in a well-organised society there would be a minimum of difficulty in deciding which labour group a man's special tastes and talents warrant attaching himself to. Where mistakes are made it is evident that the community in question has not attained to the higher development and there is need presumably of modification and improvement in the system of education."⁵ It needs no emphasis to say that the present state of Indian society is diametrically opposed to this ideal condition of society.

¹ See Mavor, "Report of the Canadian North-West," p. 36.

² See A. C. Pigou, "Economics of Welfare," p. 127 (2nd Edition).

³ Quoted in Webb's "Industrial Co-operation," p. 149.

⁴ "The Indian fathers generally set apart the fools of the family for industries and commerce. This is due to the fact that they do not possess sufficient knowledge as regards the lucrative character of these occupations. It is this that is responsible for our industrial backwardness and any industrial failures that may have been noticed. The inherent inferiority of the Indian brain for industrial and commercial business is a pure myth started by interested people. This weak point should be checked by setting "the higher educated talents towards industrial pursuits." See Sir Dorab Tata's Presidential Address at the Indian Industrial Conference, 1915, p. 19.

⁵ See A. W. Kirkaldy, "Wealth," p. 73.



There should be a system in the matter of investment as in every other walk of life.¹ If the above information is made known the existing unwillingness on the part of the savers to invest their savings would be overcome. The average requirements of the entire community can thus be grasped and until this is known there would not be much co-ordination between the savers and the users of capital.² This is the only road that will lead to increased savings, wiser investments, greater comforts, security of employment to labour and ultimate well-being of the nation. The existing owners of capital need not fear or fancy any real danger by this method of government action. All savers of capital would be considerable gainers by this method. The insuperable difficulty of finding capital which limited the industrial development in the past, is slowly vanishing under the "influence of new ideas as a result of education, new banking facilities and a new enthusiasm for the employment of capital in industries." The carrying out of the above recommendations would accelerate the speed with which capital would be seeking employment in industries and it might also augment the volume of industrial capital. Every facility has to be given to the small capitalists to obtain possession of shares of tea, jute, and coal companies. Small lots cannot be obtained and *bona fide* small investors do not really hold them. Unless this is facilitated no great development of the investment habit can be realised. Stricter laws in punishing directors, etc., who mismanage industrial companies are necessary. Wide advertisement of Government loans in the interior of the country at the time of floating the loans would make the mofussil people and small investors

¹ The policy in emigration is a haphazard and a careless one. Its harmful results are to be seen in the sad plight of our people in Kenya and South Africa. See The Annual Register, 1922, p. 254. The recent attempts of the Hon'ble Srinivasa Sastri to better the situation of our workers are related here. Some minor disabilities have been removed. Certain disabilities hindering the Indian people to take up the banana industry were removed. The acquisition of land is to be permitted in South Australia and provision of old age pensions is extended to them by the Australian Commonwealth Government.

² Under the capitalistic system there is no such collection of facts. With no accurate idea of effective demand the producers engage in industrial work with the result that sometimes there is overproduction of particular goods. This can be rectified by calculating effective demand in a crude form at least and trying to produce the things needed. Such collection of information was attempted by the Peruvian Incas in the heyday of their glorious civilisation.

to invest in the loans. It is true that the people of the villages prefer to invest their savings in land and the "psychological craving for land can only be equalled by their craving for jewellery." Land is bought recklessly at high prices though at best it can afford to yield only 6 per cent. rate of interest. This has to be checked by the development of banking business in the interior.

Besides the above measures the Indian Government should aim at the development of the resources of the country in a manner worthy of the enlightened governments like the U. S. A. and the Japanese governments. It is essential as individual initiative in this land is practically conspicuous by its absence. The peculiar circumstance in which India is placed owing to the lack of technical knowledge and lack of capital resources should be recognised. Foreign enterprise though not diffident in the matter of investment lacks the knowledge of the conditions of the country. Owing to these circumstances India has not become rapidly industrialised in spite of the lavish bounty of raw materials by nature. This situation reminds one of Mill's remark which runs as follows: "In the many parts of the world the people can do nothing for themselves which requires large means and combined action all such things are left undone, unless done by the State."¹ Under these circumstances the Government has to step into the breach. It need necessarily start all these possible industries which can be worked successfully in India. What is required is the change in the angle of vision by giving up its *laissez-faire* policy towards industrial development in general. Co-operation and encouragement of the government is necessary and as the Madras Provincial Government has done, State-aid towards industries has to be systematised and the private enterprise should definitely know what it can expect from the government.

The Government has taken the lead in all experiments for the improvement of agriculture. As the sole landlord of all India it has rightly come forward to study all problems connected with irrigation, forestry, fertilisation, breeding of cattle and improved agricultural machinery. It should also come forward, just as it has done in the Tavoy district of Burma, to encourage the successful tapping of mineral

resources. A mere maintenance of well-equipped Geological Survey with experts in commercial aspects of geological lore is not sufficient. More research from the economic side has to be done. Modern civilisation is founded on mineral as well as agricultural resources. The Government's legislative policy, fiscal policy, mining regulations, forest rules and legal codes must all be planned, designed and worked with the supreme end of developing the resources of the country in real interests of the country itself.

The Indian Government must no longer be guided by the views of the philosophical anarchists, who consider that there should be no government at all; nor by the Utopian socialists and communists who would like to transform all capitalist enterprise into an affair of the State; nor by the ultra-individualists who would restrict and confine the economic functions of the State into a narrow circle. The individualistic assumptions of the old classical school as regards the State's functions have to be expanded to suit the circumstances of the particular conditions of the society. Competition, private property and freedom of contract and the motives of business life as the starting point of an abstract and deductive science have already been modified to a great extent. The psychological foundations and the humanitarian basis of economic life have to be admitted. The economic function of State has expanded rapidly during the war. Collectivism has become the order of the day. It is not necessary for me to quote the various economic activities of the States during the war-time.¹ As Deslisle Burns points out, "neither would the State be organised as an economic community as the socialists point out nor would the purely non-governmental organisation of industry as the Syndicalists and the new guildsmen like it to be, but there

¹ During the recent war the distribution of food and fuel was regulated by the State. The means of communication, transportation and shipping facilities were controlled by the State. Even the investment of private capital was supervised. The consumption of materials and supplies in non-essential industries was limited. The price of basic commodities was fixed. The excess-profits of business men was taken for national use. Serviceable young men were forced to join the army. Emergency Fleet Corporation, the Housing Corporation, the Grain Corporation, the Sugar Corporation Board, the War Finance Corporation and the War-trade Board were specially created in the U.S.A. to perform the different economic activities effectively. See W. F. Willoughby, "Governmental Organisation in War-time and After."

would be an unprecedented combination between the two."¹ The days of competitive capitalism have been almost numbered. The idea that the Government should "keep the ring and leave it to the producers to play the game" is no longer advocated by the economists. The individualistic system of production for profit instead of for the use and of distribution according to ability without any regard of human need is criticised by a host of writers.² The only criterion for state action is the promotion of the welfare of the people composing the State and western countries are tending to curb the evils of capitalism in several ways. Ramsay Muir says, "Every government is taking action to curb the gross inequalities of property by imposing heavy taxation, *i.e.*, death duties which restrict the amount of capital that may be handed down from generation to generation by inheritance by a system of graduated taxation that takes more from the rich than from the poor by the levy of excess profits and on the other hand by the offering of banking facilities for the man of modest means, by the encouragement of co-operative production and by insisting on industrial companies offering facilities for investment by the workers."³ Thus the function of the Government is no longer a negative one confining itself towards the maintenance of law and order but a positive thing tending to co-operate, constrain, direct and reconstruct where economic conditions fail to right themselves.⁴

Even J. S. Mill who always had *laissez-faire* philosophy as the basic in his thinking admits that there is a multitude of cases in which the Government with general approbation assume powers and execute functions for which no reason can be assigned except the simple one that they conduce to general convenience. "Thus the effects are

¹ See C. Dealisle Burns, "Government and Industry," p. 8.

² See R. H. Tawney, "The Sickness of an Acquisitive Society." Also S. and B. Webb, "The Decay of Capitalist Civilisation"; Bertrand Russel, "The Prospects of Industrial Civilisation"; C. H. Douglas, "Economic Democracy," pp. 58-74.

³ See Ramsay Muir, "Liberalism and Industry," p. 44.

⁴ See H. J. Laski, "Authority in the Modern State," pp. 81-98. "The most striking change in the political organisation of the last half-century is the rapidity with which by the sheer pressure of events the State has been driven to assume a positive character and in the main it is reasonably clear that political good is to-day for the most part defined in economic terms."

to be the supreme test of all governmental action.¹ If the welfare of the people can be realised by state action the State ought to perform that action. The ethical philosophers go beyond this and point out that human welfare is an ethical end and every one ought to have an equal opportunity of achieving personal well-being. The duty of the State according to them is to equalise opportunities for all. "Happiness for all has to be justly meted out." This is the real meaning of economic moralism and the object of every State is to secure the moralised economic system.

The relativity of economic function to the State has to be understood. The individualism of the India Government does not fit in with the actual facts of the day. If the people composing the State are not advanced well in the arts of production, it is incumbent upon the State to recognise the short-comings of the people and make amends for it by its own compensatory action. Until then the general welfare of the people would not be secured. Private and special interests would be benefited. Private people tend to be guided by pure selfishness and greed and it is hard to expect that they would coincide with public good even supposing that their actions are prompted by altruistic motives. At this point the question becomes purely political and it would be beyond the scope of our subject to discuss it.

Recent economic thought is to consider "industry as a social function," Labour, Capital and the Consumer are partners and equals co-operating with one another in this service. The India Govern-

¹ "Economic moralism means public ownership and management of all the means of production, the public supply, by production and change of the requirements of the community,—namely, clothing, shelter, food, and all other articles and services required by individual members of the community, the co-ordination of all economic activities for the general or national good and the abolition of all unearned income except to the incapacitated, the remuneration of all the workers being mainly in proportion to their diligence."

² See Haldane Smith, "Economic Moralism," p. 99.

See L. T. Hobhouse, "The Elements of Social Justice," p. 30 : "of collective achievements as of collective aims, it holds good that its value is to be tested by its bearing on the actual lives of men and women."

³ See "Capital and Labour after the War," edited by S. J. Chapman, Articles 5 and 6, by R. H. Tawney and Seebohm Rowntree. See also the report of the Whitley Committee.

ment must realise this and guard against the development of the capitalism of the Western type. Karl Marx was entirely wrong in his assumption that "no country unless it passes through the capitalistic mill can make its proletariat enjoy everything as its own." Wisdom and foresight should be exercised in this matter and the development of co-operative production can go far in remedying the situation. The Indian Government ought to undertake fresh enterprises and Indianise the foreign industries existing in our country.¹

In the language of Dr. Marshall "India is developing renewed vigour and independence in industries as in thought."² The rapid recent rise of her larger industries is a source of just pride to her and of gladness to Britain. The India Government is also slowly reforming itself, adapting itself to modern conditions, abandoning "its pseudo-liberal policy of drift, neglect and mammonism, miscalled non-interference, individualism and free-trade." India has definitely embarked on a system of discriminating protection with a view to develop those industries which she can easily set up. But capital is needed to develop these and now that free-trade principles need no longer be acting as a drag³ indigenous capital will certainly come forward provided there is confidence in the ability, integrity and honesty of purpose of the industrialists. Soundness and safety are the principles which appeal to the Indian investors. The enormous sums invested in Government loans afford another proof of the availability of capital. All the joint-stock companies floated in big cities or the Presidency towns by well-known captains of industry as directors and offering reasonable prospects of success have never failed for the lack of capital. Hence, says Prof. Shah, "the myth of the shyness of Indian capital for industrial investment was manufactured for their own ends

¹ This can be done by altering the company law in such a way as to secure proportional representation of the Indian element in the Directorate of the Company. See Dr. P. N. Banerjee's *India's Fiscal Policy*, ch. on Right Fiscal Policy.

² See Dr. A. Marshall, "Industry and Trade," p. 162.

³ See the evidence of Mr. A. B. Shakespeare before the Indian Fiscal Commission. He says, "by adopting a policy of protection the difficulty in obtaining capital would largely disappear." The Minority Report of the I. F. Comn. says the same thing: "The lack of capital to which repeated references have been made is due more to the risks involved in establishing industries under Free Trade principles than the actual inadequacy of capital."



by those foreign capitalists who wanted to reserve the lucrative avenues of lavish Indian Government borrowing for themselves and there is no call upon us to give any unnecessary currency or credit to such interested libels on our people." "Money lies dormant in endless small hoards all over the country," says the Bombay Committee on the rehabilitation of the Government securities. But the chief desideratum is to organise our capital market.

The opening up of Stock Exchange with its attendant paraphernalia for the rapid conversion of the scrip into money is essential. There are only half a dozen Stock Exchanges for the whole of India. Control over the Stock Exchanges is not effective as in the case of the London Stock Exchange. Unwise speculation in stocks and shares is very often to be noticed. The idea of a government Stock Exchange has been mooted but this is no doubt the wrong remedy. The proposed legislation outlined by the Atlay Committee would go a long way in removing the malpractices of the speculators. The Calcutta Bhitari bazar is a menace to legitimate trade and tends to produce unsteadiness and harm to business interests. A properly constituted stock and produce market where "futures allowed are allowed should displace the gamblers' arena." If worked on scientific principles and under proper administrative control, the recently organised Bombay cotton market would tend towards the benefit of the producer as well as consumer, by the steadying of prices, preventing of scares and establishing direct contact between the buyer and seller. The employment of written stamped contract forms recognised by the jute trade organisation and the enforcement of the delivery of produce mentioned in the contracts within a reasonable period and the fixing of a minimum quantity of jute below which no transactions are to be permitted are essential to the Jute market.¹ Organised exchanges are essential and if wise "hedging" is resorted to all sections of the community would be benefited. Such should be the nature of the different organised exchanges either in hessians, linseed or wheat or silver or any other staple commodity.

¹ As in the case of Martin's law on the New York Stock Exchange the state must be empowered to investigate and prosecute officials possessing the swindling tendency. Mere licensing system would not cure the swindling evil. The Blue Sky laws have proved a failure in the U. S. A.



Unless such organised Stock and produce exchanges exist it is difficult to lend funds for capital purposes and keep the funds still in liquid state. Commercial Banks cannot lend for capital purposes in the absence of such Stock Exchanges where this liquidity of funds can be secured by selling the bonds on securities held as collateral for loans.

CHAPTER XX

THE INVESTMENT MARKET

Necessity for proper organisation—A National Board of Investment—Its methods—The Suppression of Investment Trusts—Municipal Savings Banks—Difficulties in their path—Premium Bonds—Instalment system of securing shares—The sale of Government Securities—Development of other sources of capital.

Necessity for Proper Organisation.

The necessity of directing the small investible savings of the Indian people into productive channels is to combat the hoarding tendency on their part and is, really speaking, the financial facet of the same problem. As long as competent bodies or organisations do not exist to point out safe and suitable outlets at profitable rates of interest the investment of their savings cannot become an accomplished fact. They will continue to be hoarded thus greatly aggravating the difficulties of the industrialists and other borrowers needing capital for productive purposes. The opening up of new avocations by creating suitable rural industries, the converting of present-day extensive cultivation to an extensive exploitation of land, the revolutionising of the means of transport and rural communications, the reorganising on improved lines the rural economy of the country, the rebuilding of most of the industrial towns and bigger cities according to recent standards of health and decency and the starting of new industries where there are possibilities of success necessitate the investment of large capital. As the capital equipment of this country is not finished as yet it follows that every attempt should be made to mobilise the savings into great pools in the first instance¹ and the safe investment of this accumulated capital on a large scale

¹ See what the Report of the Bombay Committee on the rehabilitation of Government Securities says, paras. 28 and 29.

has to be brought about. It is high time that a concerted programme and united action for the development and perfection of the investment market should be drawn up. It is only by such a policy that economic well-being and national wealth can be augmented to any extent and it would be the best available method to counteract the vicious hoarding tendency on the part of the people and check the export of Indian capital abroad.¹ Of late capital from the Bombay side is flowing into Eur-America in order to gain advantage of increased rates of interest which the dollar securities pay and the exemption of interest from taxation in the United States of America as well as from the country of origin and the assiduous publicity to dollar securities in the Indian money markets.²

A National Board of Investment.

As there can possibly be no end to the list of remunerative and useful developments³ that can be undertaken the other side of the

¹ This movement took place during the recent war period when the depreciation of the Government securities and the low rate of interest offered as their yield and the absence of good non-speculative industrial securities gave the capitalists scope and incentive to invest abroad and the appreciation of the rupee and exchange rates facilitated the outward expansion. The exact amount invested abroad cannot be arrived at as there is a great secrecy in the matter of investment carried out under the aegis of the Indian Banks. A rough guess is hazarded by a writer in the 'Economist' (London) who estimates it at £37,500,000 or Rs. 50,00,00,000. This excludes according to his opinion the investment of the native princes.

Another indirect advantage of developing the investment habit would be the increased use of cheques.

² Any amount of our national savings can be absorbed in building good roads and other durable goods needed for the development of our transportation industry. Building activities would absorb a large amount of capital, Railroads, extension of telegraphs, telephones, public utilities, electric power plants, agricultural machinery and equipment of our holdings, extension of our industrialists and businessmen's equipment need a large amount of capital. This picture in rough outline goes to show that our savings might not be sufficient to keep pace with the growing demand on the other side. Interest rates might not be on the decline until a certain amount of lubricating the capital mechanism can be done by our banking and credit structure.

³ But no accurate conception of the real income per head has ever been estimated. The Government Reports constantly speak of the rise in the standard of living of the population. Is this secured at the expense of a substantial reduction in the volume of savings or is it the result of increase of real income per head? What is the total

shield, viz., the provision of financial resources must be taken into consideration. A Board of National Investment must be created to direct the small amounts of national savings into the capital investments that are to be made for developing the nation's productive resources. As it is not the inadequacy of the capital resources¹ that is the main fear the timidity or shyness of the small savers has to be counteracted. Accordingly steps must be taken by the Board of National Investment to tap new sources of supply which are not now thrown open into investment channels. Thereby there would not only be an increase of supply but the small savers would be encouraged to invest. The success of the Post Office Cash Certificates, the recent flotation of big Government Rupee loans, the occasional booms in the matter of company flotations in spite of post-war difficulties of bad trade and labour unrest and the increase of deposits in banks and the co-operative societies which was not however at the expense of other kinds of popular savings, are a convincing proof of the fact that the savings habit is increasing and, provided safety and a certain rate of interest are assured, the development of popular savings under the aegis of the National Board of Investment would be a question of mere time.² The sum

amount of national savings any year and how is it invested are some of the important economic problems. The Board of National Investment should attempt to make tentative estimates of these and suggest suitable methods for investing new capital in new lines of Indian Industry or newer trades on modernisation of the old ones in developing transportation and construct suitable sanitary dwellings in place of the present-day slums which defy all standards of decency and health.

¹ Sir Basil Blackett hazards a guess when he says that about 12 crores of Rs. can be annually invested out of savings in *Government securities alone*. See his Budget speech, 1925-26. But an estimate of the total investible savings is desirable. Also an idea of the classes of people who save is needed for a better understanding of our economic structure.

² Unless such a timely move is made it is likely that the Indian deposits of the Exchange Banks and the premia amounts gathered by the foreign insurance companies conducting business in India would be finding investment outside this country. The Vice-Chairman of the Lloyd's Bank admits that roughly 54% of the deposits obtained in India are utilised in India and the rest utilised elsewhere than at the Indian branches. Hence there is a great danger in admitting free access to the foreign banks into our money centres. Similarly the foreign insurance Cos. must be forced to invest in India a certain proportion, i. e., 75% at least in Indian government or public utility securities. See Vice-Chairman's remarks at the Annual meeting of the shareholders of the Lloyd's Bank, 1928.

total of our past savings stands as a positive achievement and must silence most of the jingoist talk concerning the increasingly widespread poverty amongst our masses.

The Method of Work of the Board of National Investment.

A rough outline of its work has already been given and the means to be adopted so as to make popular savings easily available for industrial investment would have to be considered. The inertia of the small investors and the difficulties besetting their path would have to be overcome. The following are the means to be adopted for the encouragement of the investment habit on the part of the small investors. It has been rightly said that "Investment is as much a science as engineering or astronomy." The small investors are as a rule ignorant of the machinery or the science of investment. There are at present no means of securing this reliable information at a cheap price. The stockbroker exists only at a few places and in the absence of stock exchanges even in industrial centres it is really significant that there is a marked absence of sharks and 'bucket-shops' which abound in such numbers in other countries. If the people do not fall an easy prey to such reliable guides still their very absence connotes that there is no guidance in the choice of investments and the wise spreading of investments is impossible without proper guidance. Like that of insurance the science of investment consists in estimating the probability of risks and of neutralising them through combination. Hence the Board of National Investment must undertake to collect authentic information as regards our national savings and the general trend of the investment of these savings. The public debt policy of the Government can be framed according to the valuable light thrown on the total savings of the community and if the people perpetrate the crime of holding their savings in the shape of unprofitable non-interest-bearing precious metals it can be curbed by bringing home to such classes the futility of such investment which acts as an impediment for further savings and has a profound effect on the future generations. Propaganda by the Board of National Investment on the individual and national advantages of thrift



is essential. It should also place facilities in the hands of the people to enable them to store the small sums as they are being saved. It should come to the people and not wait for the people to come to it.

The Investment Trusts.

The Board of National Investment must be in a position to create real Investment Trusts and supervise and audit the same. Finance companies and Investment Trusts exist for the purpose of distributing the risk involved in the matter of investment by intelligently spreading it over a variety of sound investments and offer sound guidance to the small investors under this heading. It has been remarked that unless a better return of interest is offered than that of the P. O. Savings Banks or co-operative credit banks it would be difficult to tap the savings of the small investors of the country. No such trust companies which place the small investors on a similar footing with that of the big investor exist to any extent. It is only an investment trust that can help the small saver to avoid speculation by neutralisation of unavoidable risks, by diversification and by establishing a true balance between the nature of their future commitments and the nature of their investment holdings. The Investment Trusts must raise their own capital and float debentures to aid this working capital. This can be invested in a wide variety of securities always bearing in mind the principle of broad distribution of risks over many industries and over many countries or types of issue. Their clientele would chiefly consist of middle class investors who may be proprietors of the capital of these Investment Trusts or hold shares or bonds of other companies as a result of its suggestion and pioneer purchase. The delusion that an investment in gilt-edged security or Government bond is superior to investment in shares of companies must be shattered.

The true Investment Company differs from the issuing one which does financing business on a large scale.¹ The British Trusts Association is a corporation whose share-holders are financial and investment

¹ In America there is a loose terminology and the word Investment Trusts includes (a) Stock Conversion Trusts, (b) finance or holding Companies, (c) investment Trusts. Even the real investment trusts of America cannot be considered as a desirable model for

trusts. It also undertakes underwriting on a large scale and is a central investigating organisation of any issues and propositions and undertakes to supply capital to approved British concerns and enterprises. It is a great force in leading and guiding the investment of British capital. Investment Trusts are thus important factors in mobilising savings and the conservative private investors readily take up those issues which are approved and held by the Investment Trust Companies.

Although our immediate object is not to export capital, still the small investor must be in a position to get accurate information and 'play a safe hand' in purchasing from the variety of good, bad and indifferent types of securities that are available. It is this idea underlying the Investment Trust that has to be borrowed and applied to the mobilisation of Indian capital. It would indeed be difficult to organise Investment Trusts as there is no possibility of raising money cheaply at present. England could develop such institutions easily in the eighties of the last century which afforded easy economic conditions and money raised by paying $3\frac{1}{2}$ per cent. could be invested abroad at 5 to 6 per cent. rate of interest. Expert and alert management would be rare and difficult to procure at cheap remuneration. (An Investment Trust) requires active management of its portfolio by judicious investment and reinvestment. Again its holding shares in any Company must be so limited that directorial interests are not created thereby. Ample reserves should be created for emergencies. They must insist on the people understanding the fact that stocks and shares are superior to bonds or debentures. But if the Investment Trusts act in co-operation and under the rigid supervision of the Board of National Investment it would increase the popular investment on the part of shop-keepers, clerks, teachers, professional men, smaller landowners and the bigger ryots in the adjoining areas of the towns. The Board of N. Investment should see that no income-tax is deducted at the source as these small investors investing through these Investment Banks fall below the exemption limit in most cases.

imitation for they invest only in domestic companies and limit their field of operations to certain select industries alone. There are few real investment trusts like the Investment Securities Trust of America. Hence we have to consider the English models as worthy of imitation.

Limitation of individual holdings of stock can be prescribed and rigidly adhered to. These Investment Trusts would be successful in developing the investment habit and *pari passu* with it we would be able to mobilise the popular savings of the small investors. The money needed for the capital expenditure of the Government of India and the Provincial Governments and the local bodies or the Provincial land mortgage banks can be easily secured by this N. Board of Investment issuing bonds of its own and a Government guarantee of interest would be sufficient to make these bonds popular and this method can be resorted to if the necessary funds for capital expenditure cannot be secured by the ordinary loan programme of the Government and the local bodies. The Board of N. Investment can charge a slightly higher rate of interest on the loans made by it to the Government and local bodies than what it pays to the bond-holders. Repayment can be arranged on the well-known instalment basis of annuities spread over a number of years. It can be authorised to loan to other Companies at approved terms on approved securities. Without encroaching on private enterprise in any matter something substantial can be done in this direction of stimulating investments by the proposed N. B. of investment.



Municipal Savings Banks.

The starting of Municipal Savings Banks on the lines of the famous Birmingham Municipal Savings Bank has been advocated by a certain section of people as a proper means of encouraging thrift leading at the same time to sound development of local municipal bodies. Whatever might be the opinion of the Municipal Savings Bank Committee of the United Kingdom it cannot be disputed that a wisely managed Municipal Savings Bank leads to the encouragement of thrift, the wise expenditure of the mobilised funds by the municipality and the inculcation of a new civic consciousness in the minds of the people. It can invest the savings in mortgages or other securities.

Theoretically speaking the widespread influence of the Municipal Savings Bank in the direction of stimulating thrift and encouraging sound investment has not been disputed by the above Committee but



the general opinion of the observers of local financial development seems to be that unless such special conditions exist as at Birmingham it is not possible to meet with success.¹ A high civic consciousness among the people and economic management of the Bank are factors contributing towards its success. Without these favourable circumstances it would not be in the interests of our municipalities to launch out on these doubtful schemes.

Municipal
Savings Banks

Difficulties in their Path.

Until the lower classes of society have higher wages than at present they would not be in a position to save and deposit in the Municipal Savings Banks. It may lead to unfair competition with the co-operative credit societies working in the municipal area and the Post Office Savings Banks might also feel the brunt of competition and any withdrawal of funds from these concerns would affect the co-operative credit movement as well as the Government of India which at present enjoys the sole use of the Post Office Savings Bank funds. Nextly the failure of the Municipal Savings Bank would damage the general credit position of the municipality and it might also affect the credit standing of the other banks doing business. Municipal functions in the direction of health, education, road improvement and sanitation are more essential and the addition of this function would be like loading the willing horse but it might prove to be the last straw that might break the camel's back. Finally the main danger of financing "housing schemes" or "welfare schemes" with Municipal bank deposits is the locking up of capital leading perhaps towards the borrowing of funds elsewhere at a higher rate of interest to repay the depositors. Under such a contingency the main advantage of securing cheap capital would be defeated. It would be leading towards piling up of fresh duties upon the already heavily burdened executives of our Municipalities. While there are the attendant disadvantages which can however be overcome to a great degree by limiting the withdrawals in a week to a specified figure, by maintaining a portion of the assets in a liquid form and by entrusting the

¹ See the Report of the Bradbury Committee appointed to consider whether it is desirable to permit a further extension of Municipal Savings Banks—cmd. 3014 (1928) See p. 34.

management of the bank to banking experts and freeing the management at the same time from undue interference at the hands of the Municipal body and treating all borrowers, the poor and the rich alike, on an equal footing and conducting loaning operations on strict business-like principles, the possible benefit arising out of successful M. S. banks as promoters of thrift must not be forgotten. The possibility of securing profits by the Municipalities which are hard pressed for revenue is another incidental advantage which should be considered seriously. But when one glances at the Annual Administration Reports of the Provincial Governments as regards the work of local bodies we find gross incompetency, flagrant mismanagement, unbusinesslike way of doing things, infringement of legal rules, excessive laxity in the matter of collection of taxes and lack of supervision over subordinates.¹ It is impossible to entrust such bodies as the smaller municipalities with the task of Savings Banks' work. The case of the District Boards and big Municipal Corporations is however different. Even their M. S. banks must be subject to the supervision and control of the B. of N. Investment. From the progress made by some of them in the post-reform period it can safely be expected that some of the executives of the bigger Municipalities can efficiently manage the business of the Savings Bank but the question of its coming into competition with the existing agencies would remain unsolved unless they lower their rate of interest.

Premium Bonds.

The proposed Board of N. Investment must explore the possibilities of floating premium bonds or "bonus bonds" as they may be styled. This idea was first suggested by Sir Montagu Webb who wanted the Indian War Loan to be issued on the bonus basis. The then Secretary of State for India, Mr. E. S. Montagu, was of opinion that unless the principle of distributing bonuses was accepted by Great Britain, India could not follow the precedent of the continental countries in this direction. Bonus bonds are advisable as they would appeal not only as an attractive form of investment but the chance of securing a bonus which may be distributed at each quarter

¹ See "India in 1926-27," pp. 295-303.



of the year is most appealing and provides active stimulus to investors of the middle and lower classes. They cater to the present gambling instincts of people who generally bet on the race course and an issue of bonus bonds can minimise the gambling follies on the Stock Exchange as well. The issue of such bonus bonds or premium bonds as they are styled on the European continent is bound to be of great use in stimulating thrift and accelerating the investment habit on the part of the lower and middle classes of our society.

Instalment System of securing Shares.

The Board of N. Investment should also see that prominent joint-stock companies adopt the plan of the instalment system of selling shares to those who possess a banking account. It has been adopted at least indirectly to a certain extent by the co-operative societies. Under proper safeguards the American people have been in a position to adopt this practice on a wholesale plan and the small investors have not been too slow to take advantage of such facilities.¹ The employee-share system can be adopted by enterprising industrialists and railway companies who can make available preferential securities. If the B. of N. Investment supervises this scheme, this method is a suitable one for encouraging the small investors to invest in industrial undertakings.² Some of the public utility companies in America specially the Electric Companies have undertaken the customer-share-purchase system. This is the only efficient and desirable way of checking the spread of communism in the country.

The Sale of Government Securities.

The External Capital Committee recommended the sale of Government securities. The present post office organisation is doing

¹ See T. N. Carver, "The Present Economic Revolution in the United States." See also R. Boeckel's "Labour's Money," Ch. on "The Workman as Stockholder."—

Considerable leeway has to be made in this country before it can be considered that this programme is feasible. The labourer before becoming a capitalist has to build up a Savings Bank deposit account, then an insurance policy and finally become a capitalist.

² The World Economic Conference recommends the adoption of this Employee Stock ownership as a very desirable feature as it would improve the welfare of the employees and secure industrial peace and stability—"Economic Consequences of the League," "The World Economic Conference," p. 84.

something in this line and the suggestion that village accountants should be employed in the marketing of such Government securities thus cutting out the complexities of the Stock market is a valuable one and might be adopted. But the B. of N. Investment should devise continuous and lasting means and banks, co-operative credit societies, and the district treasuries should be employed by it to make available Government securities of low denomination. It alone can pursue action resembling the famous American "drive" for the sale of Liberty bonds during the period of the recent war. Something akin to this was done on a small scale in this country during the war time and by means of posters, persuasion of Government employees and widespread advertisement in places of popular resort the Government of India was able to tap the small investor's savings on a large scale. It has already been noted that the Imperial Bank has done something in this direction. Other banks should undertake to sell or purchase Government securities not only for its customers but other public at recognised rates of commission.

The Indian Joint-stock banks undertake the purchase of securities on behalf of their customers but their charges are very heavy. Brokerage fees of the broker, besides the Commission to the bank, have to be paid by the investors. Instead of this double charge, *i.e.*, brokerage and commission, the practice of the English Jt. St. Banks in securing half of the brokerage and paying another half to the broker has to be adopted. On the European Continent Banks are members of the Stock Exchange and the orders of the investing clients can be executed without any heavy charges.

Development of other Sources of Capital.

The other methods of increasing capital supply beyond the development of bank credit and the perfection of investment market must also be explored. Consumer's thrift has been pointed out already as one important source of capital. Needy industrialists and agriculturists should convert their surplus savings into actual capital aiding their enterprises. The agriculturists can depend on the direct capitalisation method to a large extent. He can dig ditches and attend to other fields of labour in his spare time. Now that the



Government have adopted the policy of steady and substantial reduction of the public debt the investors must be reinvesting the same so that a net addition to the capital supply of the country can be forthcoming. The adoption of a definite plan for the redemption of the unproductive public debt and the preventing of the progressive accumulation of debt would have to be undertaken. A sound plan of redeeming public debt would itself afford opportunities for encouraging the investment habit on the part of the people. Reinvestment of income which the rich people receive as interest on dividends is another source of capital strengthening the available funds in the investment market.

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CHAPTER XXI

CONCLUSION

The duty of the existing banks—The duty of the people—The duty of the State—The duty of the Banking Committee.

The Duty of the Existing Banks.

In order that India might be proud of her banking system all the existing banks would have to perform in future a straightforward, upright and legitimate banking business. They should check speculation on the part of the public who occasionally take 'flyers' on the Stock Exchange with the help of bankers' money. They should keep proper cash reserve, rightly utilise their loanable money in liquid assets and be cautious in the granting of loans and in the proper selection of reliable and trustworthy clientele. The banks should take care to weed out numerous weak clients and refuse to run any risk with those who fail to provide additional satisfactory securities when they require additional accommodation. They should rigidly follow the 'no risks' system and should be careful in granting uncovered credit. Too hasty and too prolific concession of credit, long-term credit, neglect of the principle of division of risk and faulty selection, excessive loans, overdrafts, loose and unbusinesslike methods of accounting, excessive borrowings by the banks, investments of bank's funds in securities of a speculative character, charging of usurious rates of interest, unlawful loans on real estate, excessive loans to officers, clerks and employees of the bank, loans to bank officers or others through "dummies," loaning money directly or indirectly upon the banks' own shares and transactions of a brokerage or commission business by the banks' executive officers should be scrupulously avoided. So long as the Indian banks adhere to these golden rules there is no danger as

regards their self-preservation but they must take care of their customers also and provide elastic bank currency which expands and decreases with the ebb and flow of business. The Indian banks should adapt themselves to the changing needs of their customers. Under the wise direction, legitimate persuasion, helpful intervention and restraining influence of the Central Bank that is to be created in their midst these Indian banks should successfully function to provide this country with sound and automatic credit currency and such amount of short-term credit as is needed for its agricultural, industrial and trading requirements. In addition to these principles the Banks should realise that they are not mere dividend-paying machines. This is but to take a base and mundane view of their functions. Until they realise the loftier, nobler and higher conception of banking business these banks will not be in a position to fulfil their mission and sacred duty to our country.

The Duty of the

It is neither the individual banks' conservative management nor the watchful guidance of the Central Bank that may successfully function in this country in the near future that can guarantee the soundness of our banking structure. The Indian people should realise that the 'modern credit system is an inverted cone resting on an apex of gold' as Lord Avebury puts it. Sir R. Giffen rightly observes 'that our credit system is to be likened to the long arm of a lever and the least touch on the cash basis displaces a heavy weight of credit on the opposite end.' F. W. Bain who continues Lord Avebury's metaphor says 'the cone is a spinning top the point alone on which it spins being of gold, the over-hanging body consisting of paper credit. Confidence is the whipping which keeps the top revolving.' A rude shock to public confidence involving the withdrawal of legal tender cash from the banks pulls the top to the ground.

The late Sir Edward Holden illustrated this fundamental truth by means of an inverted triangle. The dotted bottom of the apex is the gold basis of the whole superstructure. A removal of small portion of gold destroys a large portion of credit which in its turn affects

a large portion of commerce carried on with the help of credit granted by the bank.

So our people should have confidence in our banks. The depositors, other customers and share-holders should not lose their reasoning faculty at the first sign of threatened danger and withdraw their support from the banks.¹ The banks should be doing sound business and the depositors, other customers and share-holders should repose perfect trust in them. They should have mutual confidence and this increases consistently with the growth of general prosperity and social sympathy.

The Duty of the State.

A Central Bank should be created so as to be responsible for the currency and exchange policy of the country. The old policy pursued by the previous Finance Members of the Government of India of consulting the Legislative Assembly in all matters of currency and exchange was partly bad and wholly inefficient. The consulting of non-official opinion which was occasionally done was an important step. But it is extremely unwise to expect that in such complicated and involved questions of exchange and currency, where expert financial opinion has very often gone wrong, non-official opinion would fare better. By a few of the members of the Indian Legislative Assembly understand technical matters of this nature and to depend on their advice is entirely contrary to the policy adopted by the other enlightened countries. Relying on public opinion upon technical economic issues is unwise economic statesmanship. The limits of public opinion must be taken into account: its natural lethargy and inertia recognised; its vulnerability to the skilled presentation of propaganda understood and its unconscious social and

¹ Such a lack of confidence was displayed at the beginning of the late war in 1914. Quite recently in March, 1924, there was a run on the Bhowanipur Banking Corporation when it was known that one director had taken a loan of 3½ lakhs of rupees. Our nationalist leader the late Mr. C. R. Das had to issue a manifesto to calm the minds of the depositors and his communique created confidence with the result that the bank was saved from disaster. There was such a run in 1925 on the Central Bank of India. Since that time it has often been stated that flaws should be enacted against mischief-mongers bent upon ruining the credit reputation of our Banks.

economic bias properly measured. Viscount James Bryce who realises the deficiencies of public opinion says, "the value of public opinion depends on the extent to which it is created by that small number of thinking men who possess knowledge and the gift of initiative and on the extent to which the larger body who have no initiative but a shrewd judgment, co-operate in diffusing sound and temperate views through the community influencing that still larger mass, who, deficient in knowledge and lacking interest follow the lead given to them. Two dangers threaten.....all modern democracies. One is the tendency to allow self-interest to grasp the machinery of Government and turn that machinery to its ignoble ends. The other is the irresponsible power wielded by those who supply the people with the materials they need for judging men and measures. The dissemination by the printed word of untruths and fallacies and incitements to violence which we have learned to call propaganda has become a more potent influence among the masses in large countries than the demagogue ever was in the small nations of former days. To combat these dangers more insight and ~~by~~ ^{as} ~~why~~ as well as more energy and patriotism are needed than the so-called upper and educated classes have hitherto displayed."¹

The gold bullion standard has been adopted by the Legislature and the Government should have nothing to do with it as its managing body. As Dr. Alfred Marshall says, "the function of the legislature as regards currency is to do as little as possible. Almost any currency of which the position is certain will do its work fairly well. Frequent changes in its basis disturb expectations and infuse a spirit of unrest into business. They may all aim at increased certainty but their effect must on the balance be increased uncertainty. They resemble the frequent wakings of a patient in order to administer sleeping draughts."² In the times of an extraordinary crisis or of a prolonged war when the inflation of currency is an inevitable expedient to finance the war the Government treasury would be justified in manipulating it. Even then, the aid and co-operation of

¹ See Viscount Bryce, "Modern Democracies," pp. 456-57 and 459 to 460. See Chs. XV and XXVIII.

² See answer 11787, 1899 Committee on Indian Currency.



the Central Bank ought to be enlisted. Almost all civilised countries have left the regulation of currency and exchange to the automatic forces of trade expansion and contraction through the machinery of the Central Banks acting in co-operation with the ordinary Joint-Stock Banks. Such enlightened and conscious regulation of credit and currency should be the ideal to be striven for. The Central Banks' contribution towards stability should be the cheapening of this elastic credit and an effective control over it.

Banking Inquiry.

Years ago I ventured to suggest that there ought to be an inquiry into the working of our banking system. By means of disinterested and painstaking investigation I pointed out that the credit structure is not well-adapted to our actual requirements. It appears however that an inquiry by a Committee would very soon be inaugurated. No time is too early for such an examination of our credit system. It should tour round the important monetary centres of the world in order to study their banking systems just as the American National Monetary Commission did a few decades ago. Though its actual recommendations were not virtually carried out it has bequeathed to posterity a mass of banking literature on the different important banking systems of the world which even after the lapse of so much time amply repays perusal. There are several reasons which make the study of the foreign banking systems very helpful to us at this stage of banking progress in this country. Entering upon a career as a modern state when the financial system of other countries has been perfected, the problem of adapting the present financial system to suit the future needs of agriculture, commerce and industry becomes an easy task if a keen and comparative study of the suitable features that can be borrowed is made by a competent set of observers. The remodelling of our present financial system on the basis of the accumulated experience of others is the only thing feasible. The pioneering work in banking need not be done by this country and Indians might after all be unfitted for this work. The task of learning things by a process of trial and error is too tardy and is bound to produce disastrous effects in the absence of individual initiative, efficiency, energy

and management. It is the duty of the Banking Committee to assimilate the banking technique already in existence and by patient study we can take advantage of the results of the genius of other lands. With due regard to our special conditions and limitations we can make use of the lessons we learn from other countries. The task of creating a new banking organisation would undoubtedly have to be attempted by it.

Suggested Lines of Inquiry.

Although I agree with the opinion that the bank depositors' interests have to be safeguarded, I consider that there are other important issues to-day and the Banking Committee can do immense service to the public and secure manifest advantages to the banks by subjecting the present banking technique and actual practice of the credit institutions to a careful and expert consideration. Fundamental changes are necessary in the banking business throughout the country. Until the depositors are convinced that everything possible is being done to enable the banks to properly invest their funds, there will be no prosperity for either the depositors or the banks and the economic progress of the country would be impossible in the absence of strong banking institutions thoroughly deserving the utmost confidence on the part of the depositors. Until the depositors are given a share in the working of the banking business no efficient organisation of banking is possible. In the complete reconstruction and new orientation of the banking business the state has to play a fundamental part and without its active supervision of the banking units a better and more effective utilisation of the hoarded wealth would not be forthcoming. Without an adequately developed banking habit the banking system of the country cannot hope to secure a large quantity of working capital and finance the ever growing requirements of agriculture, commerce and industry. It is by this method alone that a real improvement in the standard of living can be brought about.

Other Important Issues.

The subject is indeed too large to permit of my entering into detail on this occasion but I am convinced that the Banking

Committee must hold the most disinterested and painstaking investigation into the principles on which a Central Bank of Issue has to be founded and also outline the operations that it has to undertake. Its position as the central institution and custodian of our monetary resources has to be carefully outlined. Without the development of a Central Bank the monetary policy cannot be shaped in an intelligent manner so as to produce the greatest possible benefit to the entrepreneurs of society and cause no loss to the revenues of the Government. It should succeed in establishing a banking system which can adapt itself to the expansion and contraction of legal tender currency as would happen normally in seasonal periods of the year or in such abnormal events as a banking and commercial crisis. A re-examination of some of the important recommendations of the Hilton-Young Commission in the matter of the Central Bank's work is essential. It is suggested that the Imperial Bank is to act as the sole agent of the Reserve Bank. It would lead to the setting up of the cry of favouritism. The Imperial Bank should not be the only "pet bank" but in the interests of banking progress it is essential to appoint other sound banks for its agency work. Even now the Federal Government of the U.S.A. places its balances in some of the National Banks. It is indeed true that this system has its own defects but in the peculiar circumstances of our country it is hard to expect the general public to repose trust in such banks which are not selected as depositaries of public money.

Likewise there should be no restriction on local governing bodies to place their deposits in any bank they may choose. Already some of the District and Local Boards are depositing their balances in the Co-operative Central Banks existing in their centres. The prevailing practice in the Scottish Banking system favours this idea. There is keen competition on the part of the existing English Joint-Stock Banks to secure the accounts of Municipal bodies and other quasi-Government organisations.

The practice of appointing different banks as agents of the Treasury was once contemplated in this country. It was suggested in 1861 that the Bank of Agra was to be given the Treasury work at Agra and Lucknow while the Presidency Bank of Bengal was to be given the Treasury work at Allahabad, Delhi, Lahore, Jubbulpore and

Nagpore. This was to a certain extent responsible for the branch expansion policy of the Presidency Banks. So the suggestion of appointing other banks as agents of the Reserve Banks deserves responsible examination in a dispassionate manner. The main advantage of such a step is to give the selected banks good prospects of future development and assures them of a settled position. The attendant disadvantage of Government funds being lent at different rates by competing banks would ensue and if there are too many depositaries it is likely to react adversely on the standard of banking. The advantages promise to outweigh the possible disadvantages and for a few years this practice has to be carried out under proper safeguards.

The Banking Committee has to suggest measures for the proper reorganisation and effective co-ordination and linking up of the up-country monetary centres with the Provincial and national money markets of the country in Bombay and Calcutta.

It has to examine all credit instruments and evidences of indebtedness in connection with loans and discounts, and bring about uniformity in bills of exchange, acceptances, bonds, stocks and debentures. The American Acceptance Council and the American Bankers Association are trying their level best to substitute standard forms. The necessity of employing uniform phraseology for the various forms of credit instruments, instructions and advices should not be emphasised by the present writer.

Another useful point of enquiry would be to make a detailed study of the extent to which machines can be used in banking offices in connection with heavy statistical work in the office. Accounting and tabulating machinery are being brought into increasing use by the American Banks. Like the Indian Railways which are making an increasing use of these machines the Banks must be able to adopt them so as to cope with the increasing volume of work without excessive additional cost, sacrifice of accuracy and speed in work.

The Banking Committee should point out the steps necessary to fuse the indigenous bankers, shroffs and other money-lending intermediaries as integral parts of a properly organised banking machinery. The possibility of developing them into modern bankers or bill brokers as was successfully done by the Japanese people in their country must be investigated.

Nextly the Banking Committee has to enquire into the different types of banks that are essential for the country. Any healthy community requires several distinct groups of banks whose special functions should be mutually exclusive. How far State aid or the sympathetic attitude and discriminating help of the State can be invoked for the purpose of initiating these diverse types of banks such as industrial, mortgage and investment banks has to be studied. The success of the Co-operative Movement is undoubtedly due to State enterprise from the outset maintained to a certain extent even to the present time and the methods by which audit and supervision were enforced have proved very effective. The State has decided to take the initiative in helping the land mortgage banks. Its systematic efforts aided by the co-operative action of the public would tend much towards the economic reorganisation of the agricultural industry. The local money-lenders who might lose their privileged position on the introduction of land mortgage banking cannot hope to offer any effective resistance to official action.

Indian banking industry is no less essential for the economic progress of the country than political autonomy or freedom to formulate measures for the social improvement of the country. Unless a new spirit is infused into the existing banking units so as to rationalise all their banking activities any attempt to adjust the supply of credit to the probable demands on the other side cannot succeed. Till a thorough rationalisation of the banking industry exists agriculture, commerce and industry cannot base their estimates for years ahead and they cannot be established with any degree of strength, capacity or success. Rationalising of banking by introducing the much needed element of specialisation by diversified banking units seeks to make a scientific study of the existing industries and industrial potentialities of the country to promote industrial progress. Rationalisation of banking seeks to promote the specialisation of credit and the more efficient use of credit. It is to the banker, the chemist, the physicist and the engineer that India has to look to recreate her economic conditions and lead to the fuller utilisation of her small and dormant hoards of precious metals and a better working out of the industrial opportunities thereby increasing the total wealth of the country and the prosperity of the people.

APPENDIX I.

Money Rates in the Indian Money Market.

1925-26—(See Report of the Controller of Currency for 1925-26, p. 18.)

1st day of the Month.	Bank Rate%	Call Money Rate.		Imperial Bank Hundi Rate%	Bazar Bill Rate.		Figures in lakhs. Cash balance of the Imperial Bank in the last week of—
		Calcutta per cent.	Bombay per cent.		Calcutta%	Bombay %	
April, 1928	7	5	6½	7	10-11	11½	2016
May, ..	7	5½	6½	7	10-11	11½	2164
June, ..	6	5	5½	6½	10-10½	10½	3398
July, ..	5	2	3½-4	6½	10-10½	9½	4686
August, ..	4	2	1½	6½	10-10½	8½	4273
September, ..	4	1½	1½	6½	10-10½	8½	3198
October, ..	5	1½	1	5½	10-11½	9½	2496
November, ..	5	2½	1½-2	5½	10½-11	9½	2160
December, ..	5	2½	3	5½	10-10½	9½	1682
January, 1926	6	3½	3½	6	10-10½	9½	1767
February, ..	6	4½	4½-5	6	10-10½	9½	1799
March, ..	6	5	5½-6	6	10-10½	10½	2523

Table of Money-rates 1926-27 (p. 18).

1st day of the Month.	Bank Rate per cent.	Call Money Rate.		Imperial Bank Hundi Rate per cent.	Bazar Bill Rate.		Figures in lakhs. Cash balance of the Imperial Bank of India in the last week of—
		Calcutta per cent.	Bombay per cent.		Calcutta per cent.	Bombay per cent.	
April, 1926	6	4½	5½	6	10-10½	9½	2831
May, ..	6	4	4½-5	6	10-10½	9½	3285
June, ..	5	2	4	4	10-10½	7½	4144
July, ..	4	2½	2½	4	10	7½	5657
August, ..	4	1	1	3	10	6½	5905
September, ..	4	1	1	3	10	6½	5039
October, ..	4	½	½-1	3	10	6½	4340
November, ..	4	½	½	3	10	6½	3730
December, ..	4	½	½-¾	3	10	6½	2092
January, 1927	5	4	4½	4½	10	8½	1700
February, ..	6	4½	5-5½	6	11	9½	1622
March, ..	7	6	6½ to 6¾	7	11	10½	1880

Money Rates 1927-28—(p. 17).

1st of	Bank Rate per cent.	Call Money Rate.		Imperial Bank Hundi Rate per cent.	Bazar Bill Rate.		Imperial Bank cash balances on the last week of the month.
		Calcutta per cent.	Bombay per cent.		Calcutta per cent.	Bombay per cent.	
April, 1927	7	6	6½-6¾	7	10-12	10½	1531
May, ..	7	5	6-5½	7	10-11	10½	1494
June, ..	7	4-4½	6-5½	7	10-11	10½	1895
July, ..	5	1½	3	5	9	7½	3246
August, ..	4	1½-2¼	2-1¾	4	9	6¾	3222
September, ..	4	2	2½-2¾	4	9	6¾	3037
October, ..	5	1½	2	5	9-10	7½	2809
November, ..	5	1½	2	5	8-9	7½	2420
December, ..	5	4-4½	4-4½	5	8-9	8½	1096
January, 1928	7	5¼-6	5¼-6	7	10-10½	9¾	1360
February, ..	7	6	6½-6¾	7	10-11	10½	1403
March, ..	7	4½-5	6-6½	7	10-11	9¾	1167

Lessons to be drawn from the above Tables.

1. Note the wide range of the fluctuations of the Bank Rate between the slack and the busy seasons—July to October is the slack season where money rates are easy. Cash balances are large during this period and the Bank rate and the Imperial Bank Hundi rate are mainly dependent on the cash balances of the Imperial Bank.

2. Note the lack of uniformity of the rates in the different parts of the country. The Bombay rates easily disclose the competition that exists for the bill discounting and the nearer approach of the bazaar rate to the Imperial Bank Hundi Rate.

3. See the diversity of money rates in the Indian money market. Besides these there are deposit rates and the loan rates for the different kinds of securities that are offered as collateral.

4. Note the high rate which the merchants have to pay in the bazaar for getting their bills discounted by the indigenous bankers. If

this rate is to be lowered as it should be in the interests of the traders, and consumers ' the indigenous bankers or the shroffs should secure greater funds through the Joint-Stock Banks and specialise in discounting bills. So long as they pay *slightly higher* deposit rate than the Joint-Stock Banks there is no reason why they should be deprived of this source of working capital. For a discussion of this measure see the chapter on the Indigenous Banker.

5. The most remarkable fact which has escaped the comment of all financial experts is the exact coincidence between the Imperial Banks' Bank Rate and the Hundi Rate during 1927-28. If such conditions were to prevail in future the Bank rate will mean as in the case of the London money market the rate at which first class bills are discounted by the Imperial Bank.



APPENDIX II.

A Brief Account of the Early Proposals for a Central Bank of Issue.

The proposal for the establishing of a great banking institution¹ which is to be a *quasi*-public institution can be traced to a very distant date. "It was in November, 1836," says Brunyate in his Account of the Presidency Banks, "that a body of merchants interested in the East Indies approached the Court of Directors of the East India Company with the proposal for a great banking establishment for would facilitate British India." The advantages cited were that "such a bank the employment in India of the redundant capital of England, stabilise the monetary system, of great use for the receipt of revenue and for the remittance to England of the money required for the home charges and to enable the East India Company to act up to the intentions of the Legislature." This proposal was referred to the Bank of Bengal for consideration and it was of opinion that it was capable of doing the aforesaid business without having recourse to England. Thus ended the proposal and nothing tangible came out of it.

The second mention of such a great banking establishment was made by Right Hon'ble James Wilson while advocating the establishment of state-managed currency in India.² Mr. Samuel Laing, the next finance minister, also viewed the proposal favourably. In his view "a central bank with state connection as exists between

¹ See the Parliamentary Papers relating to Banks published in 1868-70. A still earlier proposal of Mr. R. Rickards made in 1808 deserves mention. Considerations of space have forced me to omit a discussion of this scheme. A brief discussion of it will be forthcoming in the monograph "Organised Banking in the Days of John Company."

² "Proposals have been made for the purpose of establishing on a large scale and with an adequate capital a national banking establishment capable of gradually embracing the great banking operations in India and of its branches to the interior trading centres as opportunity might offer. There is a growing want for such an institution and a rapidly increasing field for its operations no one can doubt."

See Parliamentary Papers relating to Paper Currency in India, 1861.

the Government and the Bank of England would be a great convenience to commerce and an important resource to the state."¹

The next attempt to create a central bank was made in March, 1867 when the old Bank of Bombay failed and the Bank of Bengal proposed an amalgamation of the three Presidency Banks. According to Mr. G. Dickson the originator of the scheme, the following were the advantages to be expected out of it. "It would meet the legitimate requirements of commerce, control the recurring monetary crises and secure an unvarying management of the Treasuries under a controlling power ; afford a certainty of greater economy in the use and distribution of the balances throughout in India, provide for a uniform management of the paper currency and of the public debt under the same safeguard but with enlarged security and create a powerful agent in aiding them in all their financial resources and whose powerful action would be felt throughout the country." Although the Government contemplated inducing men of commercial ability and experience as well as men of high standing and character to come to India and manage the Central Bank the scheme was not carried out as the shareholders of the Bank of Bombay negatived the scheme. The Viceroy² condemned the proposal on the ground that the influence of such an institution would overshadow that of the Government itself ; that such an institution would be difficult to manage and that Madras and Bombay would prefer separate institutions to look after their interests. The Government had to pass Act XI of 1876 reconstituting the business of the Presidency Banks to cope with the needs of the situation.

The creation of a Central Bank of issue on the model of the Netherlands Bank was suggested in 1884 but "it was not cared for on the understanding that India possessed a sound banking and currency system."³

During the years 1899-1901 measures for the establishment of a Central Bank were in the air and there was much correspondence on

¹ See Minute, dated 7th May, 1862.

² Minute, dated 12th July, 1867.

³ See Sir Richard Temple, *India in 1880*, p. 469.

See also Algernon West, Sir C. Wood's *Administration of Indian Affairs*, London, 1867, p. 89 *et seq.*

See also G. Cheaney, *Indian Polity*, 1868, p. 465 *et seq.*

this subject between the Secretary of State for India and the Government of India. This question was keenly discussed by many of the witnesses who appeared before the Fowler Committee of 1898. Alfred Rothschild elaborated a scheme of his own for a state bank to arise out of the three Presidency Banks. The Central Bank was to be started with a capital of £14,000,000 sterling to be held partly in gold and partly in securities and it was to be granted the power to issue notes against the whole of the capital. The Presidency Banks were to be amalgamated with it. It was to hold Government balances and to have the right to import silver free of duty and to share in profits of coinage. It was to take no part in Foreign Exchange business but to confine itself to internal operations. The Government was to come to the rescue of the Bank to the extent of £10,000,000. Sir Edward Hambro, one of the members of the Fowler Committee, wrote a separate memorandum urging the establishment of a State Bank modelled on the Bank of France.¹ He thought that the Central Bank would give great assistance to the Government in the matter of regulation with reference to the convertibility of the Rupee and would act as an initiator of banking facilities like the Bank of France. The Secretary of State for India referred the proposal to the Government of India.² But Sir Edward Law, the then Finance Minister, negatived this magnificent proposal on the following grounds: "There is under the present condition no real necessity for the foundation of such a bank in the interests of trade and although the existence of a strong bank with abundant resources would be useful in connection with possible exchange difficulties and would from other points of view be convenient to Government, the direct cost of the establishment would be greater than I venture for acceptance. I am convinced that it is unnecessary to establish such a bank for the assistance of trade and unprofitable as regards the provision of assistance in connection with possible exchange difficulties, but still if practical difficulties could be overcome it would be distinctly advisable to establish such a bank so as to relieve the Government

¹ He might necessarily have derived this suggestion from Mr. Ellis, who first wrote to this effect so long ago as 1870.

² See paragraph 9 of Despatch from Secretary of State No. 140 (Financial), 25th July, 1899.

of the present heavy responsibilities and to secure the advantages arising from the control of the banking system of the country by a solid powerful central institution. The difficulty of securing a suitable Board of Directors having the necessary leisure to devote to the business is very great. There are practical difficulties in the way of amalgamation arising out of provincial and personal jealousies." ¹ The Secretary of State considered the proposal to be a good one, but as time was inopportune ² the proposal was laid aside as an impracticable one in the range of practical finance.

Lord Curzon favoured the idea of centralisation of banking facilities to be secured by the amalgamation of the Presidency Banks and proposed to grant access to it to the London money market thus "enabling it to act as a permanent and stable link between the English and the Indian money markets." ³ The Presidency Banks however objected to the creation of a Central Bank by consolidating the Presidency Banks and the idea had to be dropped once more. ⁴ In spite of the recommendations of the conference nothing could result out of its recommendations as the Presidency Banks refused to consider the question of amalgamation.

During 1910 and 1913 fresh proposals for the starting of a Central Bank were made and the most prominent of such proposals were those of Sir Edward Holden ⁵ and the *London Times*. The Under Secretary of State, Mr. Montagu, frankly approved the idea of a State Bank.

In 1913 Lord Crewe invited the late Sir Lionel Abrahams of the India Office to draw up a memorandum on the subject of the Central Bank. According to Sir Lionel "the depositing in this institution of the whole or the part of the money kept under existing conditions in the district and reserve Treasuries would place plenty of funds at the disposal of trade and industry." The substitution of the drafts on the

¹ See Sir Edward Law's Minute on the Central Bank proposal, January 31st, 1901.

² Papers relating to State Bank printed in 1913 from the Gazette of India (1899-1901 publications), p. 85.

³ See his speech on the Presidency Banks Bill, Friday, 1st September, 1899.

⁴ See J. Begbie's letter, dated 21st December, 1899, to the Secretary of the Government of Bombay, Finance Department.

⁵ See his speech before the London City and Midland Bank, 24th January, 1913. He favoured the idea of a State Bank. Even the *London Times* argued for a State Bank.

London Office of the State Bank for Council Bills, the borrowing power of the Government both in India and England were the other advantages commented on by Sir Lionel. But he considered that —“ The bank of Madras and Bombay would lose their importance and that certain technical difficulties between London and India would have to be overcome.”¹ This memorandum was placed before the Chamberlain Commission.

The Chamberlain Commission found it difficult to examine the State or Central Bank proposal owing to the absence of anything in the nature of a concrete scheme and even of any general statement as to what was implied by the phrase “State or Central Bank.” It requested Mr. J. M. Keynes and Sir E. Cable to draw up a memorandum on this question. With the help of Lord Inchcape, Keynes drew an elaborate scheme and this report was more optimistic about the working of the State Bank than Sir Lionel's. Keynes pointed out the defects of the existing banking machinery and money and according to him the best way to strengthen the system was to have a State Bank. Keynes stated the numerous objections to the scheme and disposed them off with easy and effective reasoning. The Chamberlain Commission recommended the appointment of a body of select experts to consider this question. During the period of the war the question was shelved and the Hon'ble Mr. (now Sir) B. N. Sarma's resolution upon the State Bank gave scope for discussion. In place of the State Bank the present Imperial Bank was created in 1920. But its failure to act as a real Central Bank for the banking system of the country soon opened the eyes of the people and Pundit Malaviya voiced this sentiment before the External Capital Committee. The Hilton-Young Commission took up this issue which was so long and indefinitely delayed and has done signal service to the country in recommending the starting of a central bank of issue to be styled the “Reserve Bank for India.”

¹ See Sir Lionel Abraham's Memorandum, Appendix No. 14, Interim Report of the Chamberlain Commission.

APPENDIX III.

The Presidency Banks.

The absence of vigorous and strong private banks, the circulation of depreciated currency, the lack of artificial capital, arising from credit, or the circulation of paper money, the non-existence of a money market which made it difficult for the Government and the private businessmen to borrow on easy terms, the scarcity of specie and the abnormal influence which local bankers exerted on the value of the Treasury ¹ bills of the Government soon prompted the financial advisers of the Government to commend the starting of a *quasi*-Government Bank which would afford sufficient security to the public, provide for a faithful administration of its affairs and enable the Government in times of sudden emergency to obtain necessary financial aid and regain their credit in the money market. In addition to the financial embarrassment of the Government the financial credit and prestige of the Government was at a low ebb and the Government paper could not circulate at par and a heavy discount was attached to the different denominations

¹ The origin of the present bank was due to the Accountant-General Henry St. George Tucker. As the best method to improve the state of finances he suggested the formation of a *quasi*-Government Bank in a letter to the Marquis of Wellesley (14th July, 1801). It is advantageous to note his objections to a Government Bank for these are the very grounds on which the State Bank scheme is criticised during the modern days. It would not be distinguished from the Government's treasury; the public would consider it an engine of State; it would be involved in all the transactions of the Government and there is reason to apprehend that the public under these circumstances would not have sufficient confidence in it. It would necessarily participate in the Government's distresses and its credit would be least when there might be the greatest occasion for credit in times of public calamity."—Quoted from H. St. George Tucker's criticism of the Madras Bank's plan started by Lord William Bentinck in 1805.

of the Government securities.¹ To cure these different evils the starting of a bank aided and controlled by the Government, which would be a part-proprietor of it, was at last undertaken in 1806. The Bank of Calcutta was organised in 1806 with a capital of *Sicca* Rs. 50,00,000 in 500 shares of Rs. 10,000 each.² The Government of Bengal contributed about one-fifth of the capital. Although this original capital of the Bank was increased successively during latter years as in 1836, 1838 and 1864 the portion of the Government capital did not increase in due proportion. In 1876 the Government thought it wise to sever its connection with a commercial body.³ It relinquished the right of representation on the Board of Directors. Up till this year the Government nominated three directors to participate in the Board of Management along with six other mercantile directors elected by the shareholders. The Secretary and Treasurer of the Bank was always a covenanted Civilian Officer until 1854.⁴

The Bank received its charter of incorporation on 2nd January, 1809 and the name  changed to that of "the Bank of Bengal."

¹ See the issues of the Asiatic Annual Registers—

June 5, 1802-1803 issue, p. 6.

April, 25, 1803-1811 issue, p. 96.

August 24, 1824, p. 96.

June, 1805

March 24, 1805

April 20, 1807

} Subsequent issues give the quotation of the different forms of Company's paper.

² The Bank began business with the public on June 2nd, 1806, although the first call of the share capital was received on May 1st, 1806. Dr. H. Sinha says that Symes Scutt has failed to mention this fact. However this is an oversight for on p. 13 of his privately printed and circulated book the *History of the Bank of Bengal* a copy of which exists in the Imperial Bank Library (Calcutta branch) the Calcutta Gazette advertisement with reference to the commencement of actual business was actually quoted. "Monday, the 2nd June" was distinctly mentioned on p. 13 of this book. He later on mentions that accounts with individuals were opened from Monday, 2nd March, 1807.

³ Of the Government shares, the Bank cancelled 20 lakhs thus reducing the Bank's capital from 2,20,00,000 to 2 crores represented by shares of Rs. 500 each.

⁴ Thomas Bracken and his successor must be considered exceptions to these statements. The inefficiency of a Government director as Secretary was recognised and in spite of the protest on the part of the Government Thomas Bracken was appointed by the proprietors so that real headway could be made against the Union Bank which soon began to compete effectively with the Bank of Bengal. See Brunyate, *An Account of the Presidency Banks*, p. 8.

The Charter not only defined the objects for which the Bank was created but it prohibited the Bank from conducting certain operations which would have brought disaster on the Bank. A careful comparison of the different provisions in the charter with those of the 1695 charter of the Bank of England, will lead one to the conclusion that the Indian Institution was modelled carefully on the English original.¹ Like the Bank of England which was prohibited to lend money to the King without the previous consent of the Parliament, the Bank of Bengal was also prohibited from lending more than one lakh to any individual and five lakhs of rupees to the Government. The Bank's rate of interest was not to rise higher than 12 per cent. and the Bank of England was also prohibited from raising its rate above 5 per cent. till the year 1839. It was after repealing the usury laws in that year that the Bank of England could discover the effective control exercised by its discount rate in the London Money Market. The amount of stock which any shareholder of the Bank of Bengal could hold was limited to one lakh. The Bank could not conduct trade or do any other kind of agency for the buying and selling of public securities or goods. The Charter also provided that (1) a cash reserve of at least one-third of the outstanding liabilities payable on demand should be kept and (2) the total liabilities of the Bank, including deposits, note-issues, etc., were not to exceed the Bank's capital of Rs. 50 lakhs. The Charter provided for two meetings of shareholders yearly and contemplated the possibility of putting an end to the Corporation after giving one year's notice to it.

The Charter of the Bank of Bengal was renewed in 1823² permitting the Bank to issue notes up to 2 crores and the proportion of cash to liabilities, was reduced from one-third to one-fourth. In 1824 a fraud was practised and the dividend rate fell to 2½ per cent. In 1825 the Bank opened its first agency at Benares

¹ Cf. Brunyate, footnote, p. 3.

² In order to meet the growing requirements of trade of the extended population of Calcutta it was proposed to double the capital in June, 1822. The Bank sent in a letter to that effect to Lord Hastings. The Government did not feel inclined to satisfy the Bank's wishes in this respect and as a compromise suggested by the Accountant General, J. W. Sherer, it was proposed to permit the Bank to increase the note issue to four

by transferring the Government stock to that place and selling it there and negotiating drafts against the proceeds thereof. The Bank began to issue post-bills by 1826 and a room was set aside for sale and purchase of public securities between 2 and 3 P.M. In 1829 forgeries were conducted by one Rajakisore Dutt. During the years 1829-1832 the Agency Houses of Calcutta failed and the Bank of Bengal had to experience a severe crisis and break several provisions of its charter.¹ To avoid the cataclysm of ruin and failure the Bank of Bengal had to pursue the expansive theory of lending freely to some of the solvent firms enmeshed in difficulties as a result of the failure of the commercial firms of the city. The first half-yearly balance-sheet was published in 1833. In the year 1834 the value of bank shares fell from Rs. 6,000 to Rs. 500 premium and even to par due to dividend being written off for losses on account of forgeries. But the Bank survived these bad days and began to prosper gradually. By the 1836 Charter the Bank capital was raised to 15 lakhs of Company's Rupees.² Not finding this sufficient to cope with the increasing competition of the Union Bank it soon obtained permission by the Act XXIV of 1838 to raise its capital from Rs. 75 lakhs to 112½ lakhs of Company's Rupees. A fresh charter revising most of the older regulations with reference to loans³ and permitting the bank to conduct even exchange operations was proposed in 1839. As the Bank directors thought it unwise to conduct exchange operations they made the significant addition of the words "payable in India" after the words "buying and selling bills of exchange" as a result of the suggestion made by Director Cockerell.

times the capital and the charter was granted for a period of five years. Another benefit which the Government conferred on the Bank was the remission of Government bonds deposited as security for receipt of bank notes.

¹ Even indigo factories had to be taken up under banks' management in payment of the debts of Alexander and Co. which failed. See Brunyate, "An Account of the Presidency Banks," p. 6.

² After the Sicca Rupee the Company's Rupee (the present Rupee) was adopted in 1835 and the Bank of Bengal had to use it in its accounts from 1836.

³ The former limit of advance, i.e., 1 lac was raised to 3 lacs. Another salutary measure was the provision for the formation of a Reserve Fund which was not however to exceed 5 per cent. of the capital stock of the Bank. Permission to open branches was also granted. The regulation with reference to the cash reserve remained unaltered.

An agency was opened at Mirzapore and the Bank began to extend its usefulness to its customers by undertaking to realise interest on Government and other securities on behalf of its clients. Up till 1854 much of its business consisted in investing in Government securities and lending on Government securities. Act XXI of 1854 empowered the Deputy Secretary to sign for the Bank and power was given to advance against shares of guaranteed railways. Another modification was introduced by Act XXVII of 1855 which permitted the Bank to receive, purchase, sell and realise interest on securities and shares at the same charges as hold good at the present day. The first weekly statement was issued on January 16, 1856. A glance at the balance-sheet would reveal the nature of the bank's transactions at that time. The Bank's business began to increase and about

<i>Liabilities.</i>				<i>Assets.</i>			
	Rs.	As.	P.		Rs.	As.	P.
Bank's Capital ...	1,07,00,000	0	0	Government securities ...	25,18,796	5	10
Reserve Fund ...	1,98,245	8	4	Due from Government ...	22,459	9	10
Current Accounts ...	85,76,740	14	1	Mint Certificates ...	48,94,149	15	11
Other claims ...	97,892	9	10	Cash ...	61,29,708	4	2
Bank notes and Post Bills ...	1,46,86,852	9	11	Loans ...	1,76,08,819	9	9
Total Rs.	3,42,59,731	10	2	Govt. bills discounted	94,306	7	7
				Mercantile bills ..	28,30,187	9	9
				Dead stock	1,63,303	11	4
				Total Rs.	3,42,59,731	10	2

ten European officers furnishing adequate security were employed to cope with the increasing work and a new satisfactory system of working with check Ledgers in English was introduced.¹ Thanks to the vigilance of the Government directors the Bank of Bengal did not contract any bad debts during the days of the Great Sepoy Mutiny of 1857. Although the percentage of cash went down to 22·5 per cent. it escaped disaster. The distrust of Indian people was so great that they took the earliest opportunity to convert the bank notes into

¹ See Symes Scott, "History of the Bank of Bengal."

silver. Credit was severely contracted during this great financial upheaval. The Bank soon regained its lost business and by 1862 it began to open branches in Rangoon, Mirzapore, Benares, Patna, and Dacca. Owing to the inauguration of the Government paper currency in 1862 the Bank of Bengal like its sister institutions of Bombay and Madras lost its privilege of note issue.

In order to compensate the loss it was agreed to transfer the General Treasury to the Bank and a minimum guaranteed sum of 50 lakhs of Rupees was to be granted to the Bank as Government deposit. The Bank was to be given yearly payment of Rs. 43,606 as cost and expenses to the Bank for carrying on the work of the Government Treasury. It was also arranged that the management of the Government currency was to be placed in the hands of the Bank and a commission of $\frac{3}{4}$ per cent. per annum on the daily average of currency notes outstanding and in circulation through the said agency of the Bank was to be given to the Bank. The Charter of the Bank was revised in 1862, permitting the Bank to raise its capital from 107 lakhs to Rs. 300 lakhs, and empowered the Bank to frame bye-laws and to enter into agreements with the Government and advances against goods, wares and merchandise which were not of a perishable nature could be made. The regulations with reference to loans to individuals were removed. Although the power of control remained unchanged in the hands of the Government great freedom was granted to the Bank's officers in the matter of framing bye-laws.

The Bank of Bengal soon opened branches in Allahabad, Nagpore and Lucknow and began to manage the Treasury work at Nagpore, Benares, Saugor, Jubbulpore, Patna, Rangoon, Dacca and Cawnpore. The management of the Government Savings Bank was taken over on 1st September, 1863, and Symes Scutt says that "a monthly compensation of Rs. 750 was granted for this special work on behalf of the Government." The Bank began to increase its capital in 1864 and branches at Moulmein and Hasingabad were opened in 1865. The management of the Registered public debt at Calcutta was entrusted to it and Rs. 3,500 were to be paid yearly for each crore of the Rd. public debt managed by it. It was deprived of the agency of note-issue and the terms of agreement with reference to Government deposit of cash balances were revised in 1866. The average cash balance was

to be 70 lakhs at the Bank of Bengal but if it was to fall below 45 lakhs interest was to be paid on the difference between the actual deposit sum and minimum deposit of 45 lakhs. The Bank was permitted to use the Government balances at the branches. It was also settled that Rs. 24,990 paid for branch establishments was to cease after 1st March, 1869.

The Bank of Bengal had to experience another troublous period from 1863-66. As the Bank of Bengal locked up its funds to a great extent it was unable to meet the demand of the Government on the public balances it held under its custody.

Although a very severe crisis occurred in 1866 and six prominent banks had to be closed in Bombay, the Bank of Bengal, thanks to the able management of G. Dickson, earned larger profits than usual and in 1867 it opened its branch in Bombay and until 1876 the Bank generally maintained high cash balances, sometimes rising to 5 crores of rupees, as a result of contracted credit during days of trade depression and financial distrust.

In 1876 an elaborate systematic Act applying to all the Presidency Banks was drafted and with some minor amendments by Act V of 1879, Act XX of 1899, Act I of 1909 and Act VIII of 1916, it governed the business of the Presidency Banks. The Presidency Banks became pure private concerns ; the Government having sold its shares lost also the right of representation on the Board of Directors. The power of control and authority to call for information and papers regarding Bank's affairs was only conditionally retained. Strict regulations with reference to loans and advances were reinforced and even the nature of securities on which loans could be made was closely defined. The business that could be conducted was also clearly outlined.

The Bank of Bombay was started in 1840.¹ Though the proposal was first projected in 1837 it could not materialise on account of the opposition of large capitalists. Its capital was divided into five thousand two hundred and twenty-five shares of Rs. 1,000 each. The Government of Bombay invested about 3 lakhs as their contribution towards the share capital of the Bank. It nominated three directors

¹ Greater details about its working than are given by Cooke, Brunyate or the anonymous writer of the pamphlet "The Late Bank of Bombay" will be given in my forthcoming monograph on "Organised Banking in the Days of John Company."

and the Charter was closely modelled on that of the Bank of Bengal. There were extensive forgeries committed during the years 1848-1851 and the Bank of Bombay failed in 1868. Though the Bank paid its liabilities in full, about 189 lakhs of capital out of a total of 210 lakhs were lost.

The chief cause for the failure of the Bank was the speculative mania of those days. A Commission under the Presidency of Sir C. Jackson was appointed to enquire into the causes of its failure. The report attributes the failure to the following causes: (a) the Bank Charter Act of 1863 removed many of the restrictions contained in the Act of 1840 and permitted the Bank to transact business of an unsafe character; (b) the abuse of the powers given by the Act of 1863 by weak and unprincipled Secretaries; (c) the negligence and incapacity of the directors who omitted to pass bye-laws and did not exercise proper supervision over the Secretaries; (d) the very exceptional nature of the times; (e) the absence of sound legal advice and assistance. According to Sir C. Jackson the failure taught the great lesson that "banks should not lend money on promissory notes when all the parties were borrowers and not any of them sureties for others." Throughout its period of existence it could not compete successfully with the senior Presidency Bank.¹

The New Bank of Bombay was started in 1868. From 1870-74 it had to experience difficulties. The Government could not draw on its balances entrusted to this Bank. This together with the incident of 1863 in the case of the Bank of Bengal opened the eyes of the Government as to the danger of completely merging their balances with those in the Presidency Banks. This led to the institution of the Reserve Treasuries at the Presidency towns to hold the balances which were hitherto deposited in the Presidency Banks.² The Bank Charter Act of 1876 was made applicable to this Bank. The Bank of Bombay began to prosper from that day, thanks mainly to its rigid restrictions.

At a meeting held on the suggestion of the local Chamber of Commerce at the College Hall of Madras on the 18th May, 1840, it was resolved to establish a bank with a capital of 30 lakhs (3,000

¹ See Sir Bartle Frere's Minute of 1866, quoted by Brunyate, p. 111.

² See Herald, June 6th, 1840, quoted by the Asiatic Journal.

shares of Rs. 1,000 each) and the business of the Bank was to be conducted under "the same restrictions as that of the Bank of Bengal and the Union Bank of Calcutta." In little more than a fortnight shares worth 27 lakhs of rupees thrown open to public subscription, were taken up by them.¹ Lord Elphinstone took 50 shares. The remaining shares of the value of 3 lakhs of rupees, were taken up by the Government of Madras. The plan was meant to enlarge the old established Government Bank upon the principles of the Chartered Banks of Bengal and Bombay by admitting shareholders with its consequent changes in directorial management and having an improvement in the conduct of the business. The Bank of Madras was started in 1843² and received its Charter of Incorporation in the same year. It issued notes till 1861. The Bank Charter Act of 1876 was applied to this Bank and from that date it had no chequered history as in the case of the first Bank of Bombay.³ It did good service in popularising banking business in that Presidency.

Even after 1876 the Presidency Banks did not play a useful part in the financial system of the country owing to the rigid restrictions under which they were forced to do their business. Some writers have suggested that the levying of these restrictions was solely due to the jealousy of the Government of India which was doing a considerable amount of banking business, specially the management of the exchange business.⁴ Some have attributed them to the good will of the Government which hoped that these Presidency Banks as semi-official institutions should be conducted on safe and sound lines. Though these restrictions have gone a great way in stabilising these institutions they have hindered the progress of the Banks and in spite of continuous and unceasing agitation on the part of the

¹ See Brunyate's Appendix.

² Mr. J. Ochterlony outlined this scheme so early as 1840, but for the inevitable delay in the granting of the charter see the earlier chapter of this book entitled "Organised Banking in the Days of John Company."

³ It must however be acknowledged that during the first few years of its existence loans were made for speculative purposes and a small cash balance was maintained against the total liabilities. See Brunyate, p. 80.

⁴ Symes Scutt points out that in 1836 the Bank of Bengal asked the Government of Bengal to extend the privilege of receiving its notes at all Treasuries in the N. W. Provinces. He says, "sanction was not given as the Government feared that such procedure might damage its exchange operations."

Presidency Banks since the year 1877 they have not been completely removed. But the ingenuity of the Banks' officials combined with the customers' need for money helped the Banks to break the actual spirit of the charter though not its very letter.¹

Another feature common to all the Presidency Banks was their close connexion with the Government and until 1876 they were semi-State institutions and the assistance of the Government was giving them life and vigour to a great extent. So long as they had the right to issue notes "their paper currency enabled them to adjust the supply of loanable money to demand during the busy and slack seasons." They helped to create and make the people familiar with paper currency. From 1862 they performed the banking business of the Government which entrusted its cash balances in those places where these Banks had branches of their own. They were entrusted with the management of the Registered Public Debt receiving a stipulated payment for it. The Government had the right of inspection of the different books and papers of the Banks. Their weekly balance sheets were published in the official gazettes.

The Government never thought it essential to keep these Banks under their tutelage but only reserved to itself the right to interfere in case the Banks were to go astray. As Keynes explains, "the Government is bound to come to the rescue of the Presidency Banks in the event of a wide-spread failure or crisis involving the banks generally so long as it keeps large balances outside the ordinary banking system and so long as it manages the note-issue." It was perhaps also the intention of the Government that all other Banks should look upon the Presidency Banks as model institutions worthy of close imitation on their part. The relations between the Government and the Presidency Banks were always amicable and permission was granted in 1898 so that currency chests could be established at any of their branches conducting Government business. A systematic policy of keeping a large part of its balances in the Presidency Banks² was

¹ See J. M. Keynes, *Indian Currency and Finance*, p. 202. He instances how the Presidency Banks virtually loaned money in spite of these rules. From the beginning the regulations as regards loans were "openly contravened."

² Vide Sir William Meyer's *Financial Statement, 1918-19*. See also the Controller of Currency's Report, 1917-18, paragraph 26.

pursued and this rendered unnecessary a high bank rate during the period of the late Anglo-German War.

The Government of India never realised that it was extremely unwise to restrict a growing and expanding business by means of antiquated rules. Though the first joint memorial of the three Presidency Banks, presented to the Government in 1877, agitated for permission to borrow in London and India and to deal in foreign exchanges so as to make remittances to England in payment of stock or authorised investments and in repayment of loans borrowed in London, nothing substantial was done when a conference was held in 1899, to discuss these points of grievance. Nothing came out of the representations and the conference, in spite of the fact that public opinion condemned the retention of these restrictions. Although foreign exchange business was stabilised by the adoption of the G. E. Standard system yet the Presidency Banks were not allowed to deal with the business on the plea that it would be ungenerous to encroach on the vested interests of the Exchange Banks which have done a great deal of service to this country. A more solid argument was that the Exchange Banks kept their balances with the Presidency Banks and so it was argued that the latter should not be allowed to compete with them with the help of their own money. It was feared that if competition were allowed the exchange banks would retaliate by combining with some big bank of the London Money Market. But after all the real argument that counted was that the Presidency Banks had some business or other to occupy their attention and absorb their working capital. Hence it was recognised that there was not after all much injustice in disallowing them from dealing with foreign exchange business.

Another bone of contention between the Government and the Presidency Banks was the privilege of access to the London Money Market. Although this question was raised in 1877 and although the Government of India favoured this proposal yet the Secretary of State always disallowed this measure. Even so late as in 1914 his arguments for preventing the P. Banks from having access to London were supported by many eminent economists in India. The Hon'ble Mr. H. F. Howard remarked that "the absence of such a thing was not a serious defect but it would be a useful thing." The Hon'ble

T. Smith of the Allahabad Bank thought it "unnecessary and that public opinion would be against it." Public opinion was however divided on the question of access to the London Money Market.¹ The late V. D. Thackersay and Chunilal said that "the Presidency Banks were residuary trustees and hence access should be given to them." The late Sir Bernard Hunter advocated this part of the proposal "but was against giving the Banks the privilege to deal in foreign exchange." Those who objected to the Presidency Banks being granted access to the London Money Market argued that (1) "if access were given to them it is not clear it would improve the net aggregate flow of capital into India." To allow all of them to borrow would be "to increase the number of channels through which capital may flow but the volume of it will not increase." But it was not realised that the Exchange Banks did not bring enough capital to suit our needs. Hence their access to the London Money Market ought to have been considered desirable. (2) It would involve the Presidency Banks to deal in foreign exchange while remitting the borrowed money and as it is a fluctuating business no permission to indulge in such unsafe business should be granted. But with the advent of the Gold Exchange Standard system this argument lost its validity altogether. (3) It has been pointed out that 'the money brought in by the Exchange Banks—at least a part of it—remains in India in the slack season and is invested in the rupee loans.' This improves the rate which the Government obtains for them. This would not be the case if the Presidency Banks were to obtain the funds. But the real grievance was that enough money was not brought over here. (4) The average rate for Councils will be lowered and during the slack season when money has to be sent back it depresses the exchange. It was pointed out that the sale of Council bills was not to obtain profit but "to meet the present and prospective requirements of the Secretary of State and they must be sold subject to the law of demand and supply." (5) It is quite possible that the Banks might not be in a position to pay back the loans for a call for it might be made at any inopportune time. This was after all the only sound argument against excessive

¹ Power to borrow in India was granted in 1878 but this remained a dead letter owing to peculiar circumstances of India as Sir Clinton Dawkins stated on 5th January, 1900. Proceedings of the Council of the G. G. of India.

dependence on borrowing in a foreign country. It is this which prohibits the Central Bank of any country from depending on its foreign borrowing powers. (6) It was thought inadvisable that State-subsidised Banks should be allowed to compete with the Exchange Banks in financing foreign trade. These have rendered meritorious services in the past and the Presidency Banks should not be given undue authority and advantage over these. Whatever their past services might have been no perpetual monopoly can be tolerated on this score. (7) Finally it was remarked that the three Presidency Banks would competitively pledge Government securities and would tend to lower their value. This argument at least conceded the utility of occasional borrowing to raise funds to meet unusual requirements.

Such were the reasons that were brought forth against the proposal and the plea to borrow in London was always summarily¹ refused even without recognising the real necessity for access to the London Money Market. Evidently the Presidency Banks wished to have access to the London Market so that they might borrow money there and remit it to India during the busy season. The Government balances were indeed a poor and "inadequate substitute for the note-issue." Owing to the traditional aloofness of the Government from the money market and its Independent Treasury System the evil of the shortage of working capital to satisfy the different credit needs was accentuated. As a consequence the Banks had to put up their rates at a high figure and the trading community suffered. Thus there was an acknowledged rigidity of the credit system during the busy season.²

¹ For discussion on this subject see the papers relating to the proposed establishment of a Central Bank in India, pp. 44 to 75.

² The Independent Treasury system resembles a Central Bank for deposit with branches run by the Government in which the Government is the only depositor and in which there are no borrowers. Many rupees are swept away from the Government coffers just at the time when they would be most helpful in relieving the monetary stringency in the market.

³ This feature attracted the notice of Dr. Van Den Berg so early as in 1884 and he quoted the following maximum rates of discount of the Bank of Bengal as an evidence of the inadequacy of credit for internal commerce.

Year. Bank rate. Year. Bank rate.

1876	13½ %	1880	9½ %
1877	14½ %	1881	10½ %
1878	11½ %	1882	12½ %
1879	11½ %	1883	10½ %

See Dr. N. P. Van Den Berg, "The Money Market and Paper Currency of British India," p. 3.

See also the table of figures given by Brunyate in The Account of the Presidency Banks, p. 104; the fluctuations in the rate of discount up to 1899 are recorded in the table.

The Presidency Banks proposed that they should be given the privilege to borrow funds in the London Money Market but they did not realise that it could hardly be a real and lasting remedy.¹ Unless a sufficient compensation would exist the Presidency Banks would not after all be tempted to bring over funds from London and unless they were to be employed all through the year at a fairly high rate of interest there would be no profit resulting from their borrowing in London. As such a thing would not be possible in the slack season much relief could not have been secured even if the P. Banks had been empowered to borrow freely in London. J. M. Keynes repeated the suggestion of granting of loans from the Paper Currency reserve.² The policy of granting loans was no new thing. As a matter of actual practice loans were given from funds out of Reserve Treasury. The definite policy on the part of the Government was that "any assistance in relief of the money market which may be afforded by the Treasury Reserve can be made (a) through the Presidency Banks, (b) at their published rate of discount, (c) in relief of temporary stringency." But loans were not freely given during 1893-1899 as it was thought "money would be re-lent to the Exchange Banks who may oppose the Secretary of State in the sale of Council bills."³ From 1900 loans were given on five occasions. Since 1906 there were no loans granted. The Presidency Banks did not care to borrow money in this manner as the loans were made at the prevailing bank rate and there was no profit for them if they were to re-lend at the same rate. Had there been any margin the banks would have willingly closed with the offer. Recognising these circumstances the Chamberlain Commission advocated the granting of loans to the Presidency

¹ It is indeed strange that the argument that a Central Bank should not borrow abroad or lock up its securities as collateral for loans secured has not occurred to any body. The only explanation that can be given for this is that the science of Central Banking is only of recent growth and as even Central Banks occasionally borrowed abroad at unforeseen times there could only be reference to stray arguments, but the theory of C. B.'s borrowing abroad was never scientifically conceived by either the advocates or the opponents of the proposal.

² In 1865 the Government granted the Bank of Bombay the privilege to use funds up to Rs. 1½ crore from the P. Currency Reserve. No actual use was made of this promise. (Brunyate, p. 18.) It was also suggested by the Bank of Bengal in 1898. Refer to Mr. Cruickshank's letter to the Government of India.

³ See Brunyate, "An Account of the Presidency Banks," p. 18.

Banks at one per cent. below the prevailing bankrate. But the stress of war was felt soon afterwards and these recommendations were not carried out so that no definite arrangements existed to afford temporary relief to the money market through the Presidency Banks.

Some of the other methods proposed were to issue notes uncovered by metallic reserves and the abolition of the independent treasury system. But the Government wisely refused to consider the first measure.² Till 1920 this archaic, unwise and inefficient method of dealing with the finances of the nation was continued and the Imperial Bank has at last been allowed not only to absorb the treasury reserves but has also been permitted to have access to the London Money Market. The Government have wisely insisted on the raising of more capital by the P. Banks. Lastly they have allowed the expansion of emergency currency during the busy season according to the recommendation of Sir. H. B. Smith's Committee. But in spite of these improvements high bank rates still remain as the chief feature of the money market during the busy season. It must be borne in mind that the credit requirements of the country are growing every year and the mere depositing of funds of the Government will not solve the problem. They are too slender to meet the actual requirements of the country. Access to the London Money Market would in pre-war circumstances have been an effective solution. But now that the wastages of war have to be repaired the little capital that will be available will go to the stabilising of the industrial machine whose gear has gone out of order. The London Money Market can ill spare her funds to meet the growing requirements of the Indian Capital Market. There is very little surplus capital available in London at present for further investment.³ There is a relative backwardness in the economic position of Great

¹ See Sir R. Temple, "India in 1880," p. 469. An interesting history of the episodes of the Independent Treasury System after 1826 can be obtained in the appendices of the interim report of the Chamberlain Commission, Volume I.

² See Sir Charles Wood's Administration of Indian Affairs, p. 89.

³ As Prof. T. E. Gregory points out, the London banks are "borrowing short and lending long" and it is by this stratagem that the foreign investments of London are increasing. But it is sooner or later to be followed by difficulties. See his address before the Chicago University, June, 1928; Economists' Conference on the subject of "Foreign Investments of the United States."

Britain when compared with the United States of America.¹ The usual criteria for measuring the growth of capitalism are the figures of foreign trade, production and income from investments. Owing to disturbed political conditions and the frequency of labour disputes the foreign capitalists would be apprehensive of the future and even though discriminating protection may be adopted yet the flow of capital is bound to be rather weak in the future. There are many other factors hindering the potential mobility of capital and these lie outside the scope of the banker.² So dependence on outside factors should be out of the question and so long as Great Britain aims at the maximum intensity of economic development of the Colonial Empire her first attempts would be diverted to home production and the export of manufactured material so as to increase the surplus available for investment. It is hopeless under these circumstances to expect any great relief from this source. The above three methods might act as mere lubricants in the present situation but they are not permanent and radical remedies for the chronic inelasticity of our credit media. The increase of the working capital of the joint-stock banks is the primary remedy and the empowering of the Central Bank with the right to issue notes so as to satisfy the business needs during the busy season is the secondary remedy and these are the only real remedies. A steady supply of loanable capital at moderate rates should be the ideal of the monetary and banking reform of the country.

To solve the problem of seasonal expansion of currency the first thing required is that the banking function should be co-ordinated with the note-issuing function just as one finds it in France. It should be entrusted to the Central Bank. The days of decentralised note-issuing have passed away and the Central Bank should issue notes under strict regulations imposed in a carefully outlined charter

¹ Of late Indian Industrialists tried to coax foreign capitalists into Indian enterprises but they have referred to undertake local risks and have only subscribed for a safe proportion of debentures. Even well-established Indian enterprises are finding it increasingly difficult to attract foreign capitalists so easily as before.

² Of late there has been some improvement in this direction and London is again coming forward as the world's supplier of long-term as well as short-term capital. See Viscount George Peel, "The Economic Impact of America," pp. 279 to 298. See also the Statist, October, 1928.

and, until bank notes and deposits expand in due response to trade requirements, the problem of seasonal expansion of currency without a penalising bank rate will not be successfully solved. The present method of seasonal expansion of 12 crores of rupees on the strength of remedies as laid down by the Paper Currency Amendment Acts of 1923 and 1925 would not suffice. This method is peculiar to our own country and no important country has left the problem of seasonal expansion of currency in the hands of two different authorities both of whom may be pulling in the contrary directions.

The state issuing of notes during 1861-1928 has led undoubtedly to their popularity and wide acceptance and the untutored public might dislike the transfer of the note-issue. They should be taught that the note-issuing function is a part and parcel of the banking function and it ought to be entrusted to the Central Bank which should be responsible to the Government for its sound and successful management so as to secure the wider national interests of the country.

All authors of the numerous proposals of a State or Central Bank unanimously agree on this point. They tacitly recognise that it is only through the agency of the Banks that a note circulation can ever attain a thorough development throughout the country. It is through the agency of a bank that a note-issue can be made flexible and responsive to the needs of the community. A Central Bank of Issue should be created and utilised to educate the people in the use of paper currency. It is far preferable to have an increase of paper currency through the hands of a Central Bank rather than an increasing use of token money.¹ As Dr. N. G. Pierson says, "the great increase of token money within our times must be regarded as a retrograde movement in the domain of currency. About the whole of the money should be standard money."

The real remedy for the out-of-date and unbusinesslike rigidity of the credit system is the tapping of more capital from the pockets of the people. The banking habit has to be inculcated. The people should be educated in the economical use of gold and silver they possess. The shortage of real capital can be made good by genuine savings alone. As Ramsay Macdonald says, "Capital

¹ Prof. N. G. Pierson, "Principles of Economics," Vol. I.

that is used for anything except for the specific and economic purposes for which capital ought to be used—for renewing capital for expanding the effective capital force of the country—is being misused." More of India's raw materials should be converted into finished products and not only should her idle hoards, if they exist, be utilised but the hoarding of her talents, her intellects, her economic opportunities and her unlimited resources should be discontinued.



APPENDIX IV.

The Present Position of the Bank of Taiwan after the Spring of 1927.

To give full explanation for the present position of this Bank, we must trace back to the time of March, 1927. In the beginning of March, however, in the course of discussion in the Diet, over the financial Bills introduced by the Government for the purpose of liquidating the outstanding balance of the so-called earthquake bills, it was disclosed that Suzuki & Co., Ltd., was one of the principal debtors in the issue, and this scared the business circle, with the result that the firm's credit was shaken and its financial position became extremely precarious. At this stage, the Company made to this Bank an urgent appeal for further financial assistance which, however, was declined with the understanding of both the Government and the Bank of Japan. The firm subsequently suspended its business and the financial confusion of the country ensued in which the Bank was involved. Thereupon, the Government, determined to relieve this Bank, submitted to the Privy Council a Bill for an urgent Ordinance providing for measures of financial assistance to this Bank. The Privy Councillors, while not objecting to the purpose of the Bill, differed from the Government as to the sufficient urgency of those measures within the meaning of the constitution to warrant their enforcement without convoking the Diet for its approval thereof. Following the Cabinet's resignation, the Bank branch offices at home and some others in the Far East, excepting those in Formosa, suspended fresh business for three weeks commencing with April 18th. The new Cabinet, acting on the Privy Council's suggestion, called an extraordinary session of the Diet and submitted to it two Bills, one for indemnifying the Bank of Japan to the extent of Yen 500,000,000, and the other authorising the Government to guarantee the Bank of Japan to the extent of Yen 200,000,000, in connection with the relief given to financial

institutions in Formosa, with the object of stabilising the financial situation of the country, which Bills were passed unanimously through both Houses on May 8th and became laws, *i.e.*,

1. The Bank of Japan Indemnity and Special Advance Act.
2. The Taiwan Indemnity and Special Advance Act.

The Bank's financial strength thus secured, its offices which had temporarily suspended fresh business resumed its activities from the following day.

The recommendations of the Official Committee, which had been appointed by the Government for the purpose of investigating measures for strengthening the financial position of this Bank, in accordance with the resolution passed by the House of Peers in March, and which comprised Government Officials, Members of both Houses of the Diet and the Governor and Directors of the Bank of Japan, were submitted to and accepted by the Government in their entirety in July following. This Bank was accordingly instructed by the Government to write off its reserve funds and two-thirds of its paid-up capital, in order to make good the doubtful debts amounting to Yen 1,538,235,068 and also the losses sustained in consequence of the panic. This Bank is at the same time allowed accommodation, through the Bank of Japan, of a sum of about Yen 240,000,000 under the two laws aforementioned and of a further sum of about Yen 100,000,000 on account of the earthquake bills in its possession, of which two sums it is arranged that the Bank should be relieved of its liability to repay a large portion. With these provisions, the Bank is now able to clear up its frozen debts, while getting the supply of the necessary working funds from the Bank of Japan as heretofore. It will, in future as in the past, constitute itself, under the auspices of the Government and the Bank of Japan, in Taiwan, as the central bank of issue, and abroad, as an exchange bank. Furthermore, on 20th June 1928, according to the resolution of the Enquiry Commissions which were appointed by the Government immediately after the issue of the two bills aforementioned, it was officially announced by the Government that the Government themselves undertake to indemnify the amount of Yen 185,000,000, which advanced to the Bank of Taiwan by the Bank of Japan under Taiwan Indemnity and Special Advance Act. (Please refer to

Article 3 of the Act.) By this final action of the Government this Bank's financial strength has been secured entirely on a sound basis and the bad debts, contained in its balance sheet, has been totally swept off and, thus, this Bank's position now radically improved, it will not be long before the Bank's business presents renewed activity and attain further expansion.

Bank of Taiwan Relief Act. (The Taiwan Indemnity and Special Relief Act.)

Art. 1. When the Government deems necessary for the successful administration of Formosa, for uninterrupted operation of the monetary organs in Formosa and for the maintenance of the credit of the Japanese Empire abroad, it can make the Bank of Japan advance to the monetary organs in Formosa funds not exceeding Yen 200,000,000 in amount by means of the discounting bills.

Art. 2. The period during which the Bank of Japan can be made to discount bills for the purpose of making advance mentioned in the foregoing Article shall be one year counting from the date of the enforcement of the present law.

Art. 3. In case the Bank of Japan incurs loss through the advance made under the present Law, the Government can enter into a contract with the Bank under which it undertakes to indemnify its loss to an extent not exceeding Yen 200,000,000.

Art. 4. The loss incurred by the Bank of Japan through the advance made under the present Law and the amount of such loss shall be determined by the Commission of Inquiry into the Losses through Special Advances to be organised under Article 5 of the Law providing for the Special Advances of the Bank of Japan and the Indemnification for Losses.

Art. 5. The provisions of Article 3, paragraph 2 of Article 4, Article 6, Article 7 and Article 8 of the Law for the Special Advances of the Bank of Japan and the Indemnification for Losses shall be applied *mutatis mutandis* to the advances made under the present Law and the losses incurred by the Bank of Japan on that account and Indemnification for these losses.

APPENDIX V.

Table showing the Failures of the Indian Joint-Stock Banks.

Year of Bank's liquidation.	Number of Banks liquidated.	Authorised Capital.	Subscribed Capital.	Paid-up capital.
		(00,000) omitted.		
		Rs.	Rs.	
1913 ¹	1	274	164	35
1914	42	709	245	109
1915	11	56	7	4
1916	13	230	20	4
1917	9	76	35	25
1918	7	209	4	1
1919	4	52	6	4
1920	3	10	7	7
1921	7	70	5	1
1922	15	1,015	27	8
	123	.....	.....	193
1923	20	2186	992	465
1924	18	630	26	11
1925	17	189	25	18

¹ 1913 (November and December) saw the commencement of the crisis.

*Table showing the Important Banking failures.
1913.*

Year of Rgn.	Name of the Bank with its Head Office.	Authorised Capital.	Subscribed Capital.	Paid-up Capital.	Deposits.
		(00,000) omitted.			
		Rs.	Rs.	Rs.	
1901	The Peoples' Bank, Lahore ...	35	22	12½	125
1904	The Amritsar Bank, Lahore ...	5	5	1½	28
1906	The Lahore Bank, Lahore ...	5	4½	1	29
1908	The Doaba Bank, Amritsar ...	5	3	Rs. 65,845	9
1911	The Indian Exchange Bank, Amritsar.	5	Rs. 17,310	Rs. 13,410	2
1898	The Bombay Banking Company, Bombay.	5	2	1	15
1909	The Credit Bank of India, Bombay.	100	50	10	51
1910	The Kathiawar and Ahmeda- bad Banking Corporation.	100	75	7	23

1914.

1906	The Hindustan Bank, Multan	10	20	2	10
1906	The Industrial Bank of India, Ludhiana.	5	1	Rs. 54,208	3
1909	The Public Banking and Assurances Co., Multan.	10	Rs. 17,300	Rs. 1,964	...
1911	The Bank of Peshawar, Multan	5	4	1	2
1910	The Popular Bank, Rawalpindi	50	20	3	18
1911	The Bank of Rajputana, Umbala.	5	2	Rs. 70,501	8
1913	The Solar Bank, Lahore	100	1	Rs. 8,500	...
1907	The Oriental Bank of India, Lahore.	25	10	Rs. 71,354	...
1904	The Punjab Co-operative Bank, Lahore.	25	10	8	43
1912	The Bank of Asia, Lahore	25	4	Rs. 32,099	...
1913	The Union Bank of Commerce, Bombay.	50	...	.....	...
1913	The Commercial Bank of India, Gazipore.	10	Rs. 5775	Rs. 4,250	...

1915.

Year of Rgn.	Name of the Bank with its Head Office.	Authorised Capital.	Subscribed Capital.	Paid-up Capital.	Deposits.
		(00,000) omitted.			
		Rs.	Rs.	Rs.	
1913	The Amritsar National Banking Corporation.	10	1	1	1
1912	The Standard Bank of Bombay	20	20	10	...
1912	The Cosmopolitan Bank, Bombay.	20	1	1	...

The first lesson to be learnt from these tables is the startling difference between the authorised, subscribed and paid-up capitals. The low proportion of paid-up capital which is roughly 13 per cent. of the authorised capital should be noticed.

The second lesson is that the storm centre was in the Punjab where the banks that arose out of the industrial and Swadeshi loans of 1906 came to grief.

The third lesson is that the banks have assumed astounding and misleading titles in many cases.

All the tables are taken from the Statistical Tables relating to Banks in India.

APPENDIX VI.

Specimen form of a Hundi.

हुन्डी सीकारी हरजसराय हजारामल
सेन्ट्रल बैंक जोग

Stamp Rs. 2/4/-

श्रीगणेशजी सहाय है ।

श्रीसरस्वतीजी सहाय है ।

श्री

हुन्डी सीकारी
हरजसराय
हजारामल
सेन्ट्रल बैंक
जोग

सिद्धि श्री कलकत्ता बन्दर शुभस्थानके श्रीपत्नी साहजी,
श्रीहर जसरायजी हजारामलजी जोग लिख । तब सेती मेवाराम
भोलाराम । जयगोपाल वंचना ।

वपरंच हुन्डी किता १ आपके ऊपर करी रुपैया २५०० (अर्के
रुपैया पचीससोका नीमि रुपैया वारासो पचास का दूना पूरा देने
अठराख्या साहजी कालूरामजी ब्रिजमोहनजी लालजी बम्बैवाला
पास मितो पोष सुदी १ सोमवार दिन ७१ एकत्तर पीछे साह जोग
रुपैया कंपनीचलन धान दोजो देना हमारा बटुभे नवा लिखाने
मितो पूष सुदी १ सोमवार संवत् १८८० ।

दः—संकरलाल ।

१॥ साहजी श्रीहरजसरायजी हजारामलजी जोग ।
मु० कलकत्ता ठिः बड़तला गल्ली नं० २६ ।

Explanation of the Hundi Form.

Bombay, 4th January, 1924.

Drawn by Mewaram Bholaram,

Drawn on Harjasrai Hajari Mal, 26, Burtollah Street, Calcutta.

In favour of Kaluram Brijmohan.

Endorsed by Kaluram Brijmohan.

Dated 7th January, 1924.

Term 71 days.

When accepted.

Due 21st March, 1924.

Amount Rs. 2,500.

APPENDIX VII.

General Questionnaire.

1. Where do you get your gold and silver from? In bullion or in sovereigns? Which of the gold bars of the Banks are popular and much in demand?
2. What is the amount of your capital and what is your relationship with the gold and silver bullionists of Bombay?
3. Do you occasionally place gold bars in the Imperial Bank and secure advances? If so, at what rate of interest?
4. To whom do you generally sell gold bars or sovereigns? In what average quantities?
5. What is your opinion that gold is replacing silver in hoards?
6. To whom do you sell silver? And in what quantities?
7. In what portion of the year is your business slack and when and how long does your busy season extend?
8. How many years since have you started this business? What is your opinion as regards this gold absorption on the part of the people?
9. Would there be the effective circulation of sovereigns or gold pieces say of 10 Rs. value or any other suitable coin?
10. Can't the aesthetic tastes of the people be improved by use of diamonds, gems, etc.?
11. What is your experience of the resale of gold and silver ornaments by owners in times of economic pressure and necessity?
12. Do the ryots and agriculturists or the middle class and richer professional people generally frequent your shop and can you state in what proportion your business would be transacted with the above classes respectively?

13. What is the turn-over of sale of gold and silver in the busy or the marriage season and to what size would it shrink generally in the off season ?

14. What is the turn-over of the sale of locally prepared Lakshmi, Saraswati and other half-sovereigns ?

15. Do you consider it possible to increase the investment habit on the part of the people by increasing their education and pointing out to them the futility of this barren locking up of savings ?

16. How many are there roughly of such retail bullionists of your stamp? What would be the approximate turn-over of the sale of gold and silver by the bullionists ?

17. Do you combine any other business such as money-lending along with your recognised bullion business ? If so, what proportion of capital is locked up in the different forms of business ?

18. Do you take to attract deposits and hold them when offered and what rate of interest do you pay ?

19. Does the Bank rate affect your business and in what way? Do you draw or discount hundies ?

20. Do you speculate in the value of Government securities and if a Stock Exchange were to be started in your locality would there be a brisk business in the Government and trustee securities ?

APPENDIX VIII.

THE GOLD BULLION STANDARD.¹

Introduction.

India is a country in which changes of currency are a great danger, for they make or mar the future of our Indian people. They frighten and exasperate the people and shake their confidence in the new currency proposals that are foisted on the uneducated population, unable to adjust themselves to any changes from the normal state of things. The present political atmosphere brooks no unwise tampering with it and brand new experiments should never be tried. The Gold Bullion Standard proposes to inaugurate a most significant change and introduces another experiment in the currency history of the country. The *ultimate* dethronement of the Silver Rupee and the proposed circulation of inconvertible paper currency² would not fail to exercise profound influence on the social habits of the people and on the price of silver. Hence it is imperative to examine the theoretical soundness and its practical utility to the Indian economic system. An examination of the Gold Bullion Standard must be conducted neither in the light of exaggerated optimism or pessimism nor political prepossession, but in the cold light of economic reasoning and trained judgment. It must not also be forgotten that the principles of banking and currency are dynamic and not static. The recent modification or purification of the conception of the Gold Standard System must be borne in mind while analysing the Gold Bullion Standard conception.

The Essential Features of the Gold Bullion Standard.

It is an *absolute* Gold Standard without gold currency. Gold is the world's standard and India adopts the same as the standard of

¹ This paper was read before the Indian Economic Conference held at Calcutta, January, 1927.

² Theoretically speaking they are convertible into gold bars alone but this absolute right of convertibility into gold cannot be practically exercised except at limited amounts. Hence it is often referred to as the inconvertible note.

value. The local currency is established in relation to gold. The integral and distinguishing feature is that gold coin is not to be in circulation. There is no real conspicuous and visible embodiment of the Gold Bullion Standard in the shape of a gold unit. Gold bullion is to be used for the payment of international indebtedness and it would be freely available for internal purposes. The people possess the rights of convertibility of local currency into gold, the power of melting it and exporting it out of the country.

There is a fixed gold parity of the local currency unit, i.e., the silver rupee or the paper currency note which is 8.741 grains of fine gold. This is to be the imaginary common standard unit of value or money of account, instead of the present silver rupee which is considered as the standard unit of account by the people.

The currency authority has to buy and sell gold without limit at the fixed par value of the rupee (1s. 6d.) in quantities of not less than 40 fine ounces. Gold is to be given in exchange for local currency, either notes or silver rupees. The sale of gold is so arranged that the currency authority would not become saddled with the task of supplying gold bullion for non-monetary purposes also. The interests of the gold bullion market are thus protected.¹

The currency authority's sole duty would be to effectively assimilate gold imports and regulate the consequences of gold export. Resolute monetary control, seasonal expansion and contraction of currency and future banking progress are to be the actuating ideals of this institution.

Reasons for taking this Step.

As India has been sufficiently educated in the monetary field by the use of token currency, and the use of notes and as they have placed greater reliance on notes than coins during the years 1916-1919 even though the fiduciary issue has been greatly expanded, the gold bullion standard would be acceptable to the people. It seems to be a

¹ But if a higher price is charged for laying down gold in London than the actual cost of transport and loss of interest it would be considered a legitimate grievance on the part of the people. Similarly a far higher price than the actual cost of laying down gold in Bombay and loss of interest should not be insisted upon.

rational development of the present monetary system. The rupee would be kept in constant relation to gold at a fixed par value. The ideally best token being paper, this ideal would be best reached under the Gold Bullion Standard. Powers of psychological suggestion and well-directed propaganda would have to be employed so as to secure sufficient general enlightenment in currency matters.

The position of the quasi-standard rupee is such that it cannot be declared limited legal tender and brought into disrepute. There are roughly 647 crores of silver rupees minted and although some of them might have been melted the present volume in actual circulation might be estimated at 150 to 250 crores of rupees. Any undertaking of the immediate conversion of these existing silver rupees and the hoarded ones into gold would be unwise, as India would be unable to foot the bill. It would be difficult to suggest any practical limit to the amount of gold required for this purpose. Even if India is unwise to neglect her own interests and be short-sighted as not to protect the silver hoards of the poorer classes, financiers in other countries have become alarmed at the question of India's return to a pure gold standard and the large absorption of gold that would be required for this purpose. Under these circumstances any co-operation in giving a loan for gold standard purposes would be out of question. Hence to put an end to the present drift policy in currency matters the Gold Bullion Standard has been perfected and so far as India's admission into the financial society of nations is concerned it can be obtained by the Gold Bullion Standard. Effective participation in formulating the world's currency policy can also be secured if the proposal for the starting of a separate Central Bank materialises.

The previous Indian currency system has assigned no definite place to gold. Without recognising the fact that the value of gold would be changing according to demand and supply for it, the Government of India undertook to fix it down at a constant value to silver coin. Again they undertook to receive gold coin at this rate but not to pay it back to the people. Thus there was no definite policy with regard to the position of gold in the Indian currency system. It was allowed to circulate as legal tender though in fact it ceased to circulate. This anomalous position is now ended and the Gold Bullion Standard has definitely given up gold coin as a form of internal currency.

The Merits of the Scheme.

India can obtain the gold she requires through trade channels. As gold coin in circulation is not allowed, there would be no frittering away of capital which can be used for the economic development of the country. The gold currency is an obsolescent feature in all civilised countries. The economising of gold which is recommended by all theorists¹ and warmly advocated since the days of the Genoa Financial Conference can be carried out effectively under the Gold Bullion Standard. The unlimited acceptance of imported gold at par and unlimited issues of gold for export at par are the cardinal features and a strong reserve of gold would have to be amassed for fulfilling these functions.

There is no immediate degradation or blowing up of the rupee. Any signing of the immediate warrant of the rupee by demonetising it would cause nervousness on the part of the people. Its long history and traditional position are respected and it tends to remain the standard unit of currency till people understand the new standard. Even the silver interests of America or China need not be afraid of an immediate drastic reduction in the price of silver. The Government of India has receded from the silver market so long ago as 1919 and the silver producers do not count on the Government of India as an important factor. The sales of silver by the currency authority, which it might deem necessary to sell during the first few years of the working of the Gold Bullion Standard, would not happen if rupees go into circulation. The Government and not the new currency authority would remain the purveyor of the silver rupee. The present invisible taxation paid by the country in circulating debased currency such as the silver rupee at an increasing value would be rendered unnecessary. The eventual withdrawal of the right of

¹ See Ricardo, "A proposal for an Economical and Secure Currency." He can be styled the "father of the Gold Bullion Standard scheme." He recommended the use of a paper currency resting not on coin basis but of standard gold bars each weighing 60 ozs. If currency were to be in excess it can be taken to the mint and exchanged for gold bars for exportation. If it were deficient gold bars would be brought to the mint and currency demanded. For internal purposes paper would be sufficient and a suitable medium of exchange while for external purposes stamped gold bars could be better suited than coins.



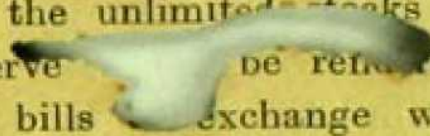
converting notes into silver rupees would force India to depend on the inconvertible paper notes issued by the Central Bank.

The overpowering influence of the India Office in financial and exchange matters would be removed, for the currency authority in future would be the Central Bank who would be responsible for the soundness and flexibility of the currency system of the country. As banking facilities tend to develop, the discount policy of the Central Bank would enable it to maintain sound monetary conditions. Currency with a stable value is a *sine qua non* for the development of banking and as the Gold Bullion standard secures stable currency, wide and proper development of banking facilities can be expected from a successful working of the Gold Bullion standard. The bank note issued by the Central Bank, which is to be the future currency authority, would become the apostle of deposit banking in the country.

The Paper Currency Reserve and the Gold Standard Reserve whose functions were never clearly demarcated in the past get combined and are placed on a statutory basis. The gold in this reserve would prove an adequate support to the exchange, and the external value of the local currency unit would be safely maintained under this arrangement. A proper mobilisation of the reserve would tend to facilitate the turnover of the currency. However the right of double convertibility cannot be secured under the G. B. Standard. The new notes cannot be converted into both silver and gold and such a permanent arrangement cannot be secured even under a pure gold standard. Hence while there is the *de facto* convertibility of notes into silver rupees there is no *de jure* convertibility.

The automatic nature of the Gold Bullion Standard system would be as effective as in the case of a pure gold standard with gold currency. The favourable trade balance would lead to a free flow of gold bullion and as this is bought by the Central Bank, the local currency is released by bank payments made in purchase of gold. The unfavourable trade balance is to be liquidated by the export of gold bullion which has to be purchased by the Indian importers from the currency authority. Gold bullion can be pumped in and out with great ease and facility as the gold import and export points are fixed by statute. This places her on a position

of equality with other gold standard countries. So far as internal stability is concerned the ideal of monetary stability can be easily secured through the administrative action of the Central Bank. If the world prices fall a corresponding deflation can easily be managed by the Central Bank's influence on the credit situation. If world prices rise there would be quick adjustment again by the Central Bank's quick action on the internal currency situation. Now that the gold standard has been restored monetary stability in this country means the adjustments of internal currency to the world unit of prices or those of England and the U. S. A. the most important gold standard countries.

The Indian Currency system requires great expansion of internal currency during the busy season for financing the movement of crops and contraction of the same during the slack season. The purchasing of the unlimited stocks of silver or the tinkering of the P. C. Reserve  be rendered unnecessary by the currency authority. As bills  exchange would become popularised and drawn for the payment of the crops, these would be discounted in the money market and the banks requiring further resources would re-discount these bills at the hands of the Central Bank which can issue notes on these commercial bills. The Bank can buy gold bullion from the people and this would expand the volume of the local currency. The centralising of the currency and banking reserves in the hands of the Central Bank would reduce the fluctuations in money rates and the hitherto divergent policies in regard to currency by the currency authority and banking by the banking authority would be given up. Internal prices would be placed on a more stable basis than under the G. E. standard system.¹ The proper regulation of the discount policy by the Central Bank would make the currency expansion and contraction automatic. The statutory constitution of the combined reserve to be placed in the hands of the Central Bank allows it to expand and contract currency according  seasonal demands. So far as automatic

¹ There should be no misapprehension under this heading. Absolute guarantee against fluctuations in purchasing power is not afforded by the Gold Bullion Standard system. Nor can it be attained by any other system which has so far been outlined by monetary reformers.

contraction is concerned it can be brought about as soon as people feel that local currency has depreciated in terms of gold and they would hasten to the bank to convert the local currency into gold bullion which the bank has to sell.

The Gold Bullion standard does not debar the country from the possibility of the ultimate resumption of gold currency. Thus the gold currency standard can be reached if sufficient gold reserves are accumulated, but the education of the people in the use of the new inconvertible rupee note and the other denominations of paper currency popularised by the Bank would be such as to open the eyes of the people to realise the uneconomical character of gold currency. For the time being there would be no free internal circulation of gold, but it is quite likely that if banking education proceeds apace we would never be desirous of it. The introduction of the one rupee note would go a long way in this direction. It would soon become the principal internal currency.

The institution of the "On Tap Savings Certificates" redeemable at the end of three or five years in legal tender money or gold bullion with an attractive rate of interest attached to them is a modest attempt to counteract the unproductive employment of the yellow metal. Though they are poor substitutes of gold notes which carry the right of convertibility into gold coins, they can do much to encourage the investment habit on the part of the people who can afford to save.

The demonetisation of the gold sovereign is also a feature which should not escape one's attention. The sovereign has been both a "benefactor and the nightmare" of the Indian currency system. The obvious advantage is the possibility to introduce a new gold coin and gold mint in our country when gold coin is considered necessary, and the position of the reserves is such as to facilitate it. The present demonetisation of the sovereign would be no real danger, as India's main demand for it is only a bullion demand, and not a coin demand. The bulk of the Indian people find the rupee a more suitable coin than the sovereign. The gold sovereign is not a real Indian coin. Besides this reason we have the following most important reason for demonetising the sovereign which is not usually taken into consideration. For a

supply of this coin India has to depend on England. The currency authority in India cannot control the issue of this coin and such a coin should find no place in the Indian currency system. A sound currency system is that which gives scope to the currency authority to control and regulate every important coin which is a constituent feature of the system.

Supposed Demerits of the Scheme.

The working of the system in all its details will take some time to begin. There should be the formation of the Central Bank and the accumulation of the necessary gold reserves in India. A large number of rupees would be presented to the Central Bank for conversion into gold bullion. There is already a fall in the price of silver and its future fall would stimulate the demand for gold. It would be unwise for the Central Bank to begin operations with a slender stock of gold. In other respects it can begin straight away. Some of the measures that can be taken up immediately for increasing the gold stock of the Central Bank should be considered. The import duties can be made payable in gold or gold equivalent. The Indian export bills are to be taken up in sufficiently large number and gold can be secured from their proceeds. An attempt to retain the gold produce of the country should be made.

The first essential of a currency system is that it can be understood by the people and that it should be of such a nature as to be acceptable to them. The popular sentiment is in favour of a gold standard with gold in circulation. When this is denied it would be considered rightly or mistakenly that it is less automatic and less free from manipulation than the pure gold standard with gold currency in circulation.

The position of the silver rupees would be looked upon with certain misgivings as the people would not obtain them as a matter of right from the Central Bank in return for its new notes. The new Reserve Bank note and the silver rupee would both be legal tender currency in the Gold Bullion Standard system. Holders of notes can secure rupees only at the will of the Reserve Bank. The paper note

is neither convertible into the silver note, as at present, or into a gold coin but both these are convertible into gold bullion—the standard of value. The exchangeable limit of the local currency into gold bullion is too high.¹ It is only the bullionists and the rich men that can afford to do it. The present note-issue is convertible into silver rupees and the issue of a new inconvertible note would tend to make the people cherish the present note and the new inconvertible note would be at a discount. It might be a note payable in gold but the legal line of difference drawn between the old and the new double-guaranteed bank note is to be deprecated.

There is no statutory undertaking that the free inflow and outflow of gold would be permitted without any direct or indirect limitations on the amount of gold coming in or going out. The location of the gold securities in London would not be liked by the people. As the Central Banker's gold reserves might again be depleted too readily when the necessary internal gold attempts have been made to protect the Bank against a drain. Similarly the free inflow of gold must be ensured.

Although we have at present an excellent opportunity to settle the national currency question, the Currency Commission by prescribing the Gold Bullion system has not succeeded in this task. The G. B. standard can at best be accepted by the people as a half-way house leading to the adoption of the pure gold standard with gold currency in circulation in the near future. Academically speaking the G. B. standard is a step nearer to the international exchange standard recommended by the G. I. Financial Conference and is really an improvement on the Gold Standard with gold currency in circulation.

Comparison with the G. E. Standard.

It has undoubtedly the following points of superiority above the defective G. E. Standard system, *viz.*, the giving of gold bullion in return for local currency for all purposes, the statutory basis of the combined reserve, the banking management of the currency and credit policy and the economy of gold. It is doubtless inferior to the effective G. S. plan, at least from the standpoint of public sentiment

Even the 1927 Gold Standard Act has not done sufficient justice in this respect.

and confidence. It is the fond hope of the economists that a gold currency would make it possible for India to mobilise the liquid resources and increase the turnover of currency. But the main point of increasing the capital resources cannot be solved by merely multiplying currency. Greater means for mobilising capital resources are the real remedy. It would require an extensive educational campaign to make the people realise the true implications of the Gold Bullion standard. Otherwise appeals to economic arguments will become vain in face of the existing and overwhelming liking for the gold standard with gold currency in circulation.

No Danger to Trade.

It is openly stated that trade with Africa and the countries on the Persian Gulf would be hindered as the present financing medium is the silver rupee. The demonetisation of the rupee would however give an opportunity for adjustment and no serious danger need be felt.

The view is too often held that India is a sink of precious metals. Although this is quite a superficial view it must be admitted that an unwise use of existing stocks of gold is being made by the uneducated people. This is likely to continue under any system. Increased education, improved legal and economic status for women, the raising of the standard of living and the development of banking facilities are the necessary correctives. But as the existence of this habit would have an adverse effect on the gold reserves of the Reserve Bank, every attempt must be made to change the ways and habits of the people with reference to the accumulation of the precious metals. Monetary reform and banking re-organisation must be considered as mutually convertible terms; the one cannot succeed without the other. Both must go hand in hand.

Should we accept the Gold Bullion Standard or not ?

Although several economists and witnesses before the Hilton-Young Commission have pointed out that India has to pass through the necessary stage of gold currency in circulation before it could hope to attain the ideal currency system, this advice has been

disregarded. The gold standard as understood in the modern sense, is readily granted and the means to secure gold currency in future are carefully preserved so that an 'optional gold currency' can be grafted on the currency system. The preliminary stage is accomplished and although the Commission do not think it advisable to vote for the gold currency ideal, it can be secured through the will of the Legislature as soon as the gold in the reserve permits it.

The scheme can be accepted if the Legislature can introduce the proviso that after the lapse of a certain period the right of coining gold bars into coins or mohurs would be granted to the people if they so desire it. The composition of the gold in the reserve should be placed at a high ratio of the total amount and as soon as this high portion of gold is reached, the right of giving gold to the holders of silver and coins can be undertaken. Thus at last can we rid ourselves of silver and "slough off the remains of the old skin." The rapid attainment of the *gold standard* on increased education, the raising of the *standard of living*, and the perfection of the banking system, and when these are secured the uneconomical nature of the gold currency would be realised. The Gold Bullion Standard would remain *in toto* without the unnecessary excrescence of gold currency attached to it. There would be no need to feel any regret at this conclusion. The currency question has been racking India for the past several years and it will continue to do so for a longer time under the Gold Exchange Standard system. Until we are prepared to accept and use the new currency bridge, *i.e.*, the G. B. standard, the attainment of the ideally best currency which is the ultimate goal, would be postponed *ad infinitum*. Academically viewed the G. B. standard is infinitely superior to the present policy of drift in currency matters. Practically speaking it is the only successful monetary reform that *unaided* India with its *meagre resources of gold* can achieve with maximum profit and minimum disturbance to our country as well as others. Sentimentally viewed, it fails to take cognisance of the overwhelming liking of the Indian people for gold currency in circulation. Psychologically considered it is a bitter disappointment to popular expectations.

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